

UK: CORONAVIRUS AND THE FCA EXPECTATIONS OF THE INSURANCE SECTOR

On 1 May the Financial Conduct Authority ("FCA") announced a series of statements and guidance to firms regarding the impact of coronavirus on the insurance sector.

There has been an understandable level of focus on the FCA's plan to seek judicial interpretation of certain business interruption ("BI") clauses, but there are two other key issues arising from the FCA statements that may provide, in the long run, to have just as significant an impact on firms:

- the proposed guidance on the impact of the lockdown on the value of insurance products and how firms should address this issue; and
- the risk of mis-selling claims against insurers and intermediaries in relation to BI policies that do not respond.

The Question of "Value"

Under the FCA's proposed guidance, insurers and intermediaries have been given 6 months from the date of the final guidance to consider whether and how coronavirus has materially affected the value of their products and how to treat customers whose products have lost value. However, the FCA want to understand how firms will implement the guidance in practice and want to know whether the guidance is sufficiently clear. The consultation period expires on 15 May so we would expect that the final guidance will follow soon thereafter.

The guidance requires firms to assess where the effects of the lockdown mean that either (i) claims cannot be made as the insured event can no longer occur, such as public liability insurances for businesses that remain closed such as bars and restaurants; or (ii) where insurers cannot provide contractual benefits in the expected form or timeframe, for example annual boiler servicing or routine dental appointments.

These triggers seem clear, although there will be some uncertainty in some areas. For example, as we come out of lockdown it may be possible for boilers to be serviced within an annual plan. On that basis, the presumption must be that the trigger is not met although it's not necessarily clear in the guidance. The FCA then requires that, once firms have identified the products within scope of assessment, they are best placed to assess what the appropriate response should be. Examples, such as premium refunds, are given. The indication is that the FCA may review these plans so firms will need to consider if and how best to engage with the regulator in putting plans in place.

Key issues

- The FCA proposed 'product value' guidance gives firms 6 months to consider the effects of lockdown on their products.
- The FCA requires an assessment where firms or the product itself cannot deliver a benefit, or where the customer cannot make a claim as the underlying event is no longer relevant.
- Where a firm identifies something that could materially affect the value of the product, they should consider the appropriate action to take.
- Specific actions are not mandated but the FCA expects firms to demonstrate to it how they have met their obligations at a product level and how they have treated their customers fairly.
- The FCA's statement on BI insurance raises the possibility that certain customers may have been mis-sold a BI policy, as there may be a gap between the firm's and the customer's understanding of what was covered.
- Firms should review the FCA's statement and consider their position and how they would respond to any complaints.

The FCA's statement is clear that firms are not expected to undertake a value assessment for products where a claim is still possible but the likelihood of a customer making a claim may have changed, but firms may choose to consider including such products in their support package. However the guidance then goes on to state that in these type of circumstances, firms should consider the value of the product where a customer contacts them because they are having difficulty making repayments, wish to reduce cover, or have made enquiries about their cover in light of coronavirus or where the firm has a reasonable basis for knowing, or has identified (or should have reasonably identified) that there are customers who are suffering financial distress such as missed payments, even where those customers have not contacted the firm.

This is potentially very challenging for firms and creates uncertainty in the guidance. It is unclear whether firms are only required to track these two instances (i.e. where a customer contacts them or where a customer gets flagged because they missed a payment) or whether they should be conducting a larger diligence exercise and reaching out to their customers to understand if they are experiencing financial difficulties. At a minimum, the guidance provides that firms should make clear in their customer communications, including on their websites, the different solutions available to customers and encourage them to make contact if they are experiencing temporary financial difficulties as a result of coronavirus.

Although the guidance is immediately helpful for those scenarios where the value assessment and corresponding remedy is clear-cut, it will be more challenging for firms to conduct value assessments and implement appropriate actions for certain products which may still provide a partial benefit to customers during the coronavirus period. In particular, the government's latest measures to take the economy out of lockdown lack the required clarity that businesses need to work out how they can operate in the current climate and foreseeable future.

The government has since released its plan for restarting the economy and the gradual easing of lockdown restrictions and firms will need to consider the impact of these developments on this question of value. The assessment of value has the potential to become more complicated in this period - for example, as at the time of writing, restaurants are not permitted to open, but can provide a takeaway service. In those circumstances, what is the assessment? It is certainly less clear than when in complete lockdown.

As the impact of coronavirus looks to extend into the rest of this year and beyond, we expect to see more from the FCA on product design and "value" well beyond this initial 6 month assessment period.

The Mis-selling risk

In the FCA statement on BI insurance, they note that there will, of course, be a significant number of policies that do not respond to the particular circumstances of the coronavirus pandemic and the lock down. Insurers have argued that policies were not designed for this type of loss - which is not limited by geography or time - and that a pandemic, which does not have these limits, is not an event which the policy would or should cover. Policyholders may well take a different view.

The FCA state that, for these cases where there is no cover, there may be a "gap between the firms' and the customers' understanding of what they

thought was covered by the policy". They state that customers may look to bring a complaint in these circumstances, noting in particular **"if the policy is not consistent with what the customer requested or instructed OR with what the customer was informed was being provided"**.

This, therefore, raises the spectre of insurers being successful on the policy wording, but then they and/or intermediaries are facing mis-selling liability risk. It is to be expected that there will be a significant number of complaints and, undoubtedly, the analysis will be fact specific. That said, how often will an exclusion for a pandemic have been specifically discussed between distributor and policyholder? Is it reasonable to expect every exclusion to be brought to the attention of the insured? Looking at the FCA statement, you would expect that most policyholders would take the view that they would have "requested or instructed" cover in the widest terms possible. We doubt that anyone would say that they requested cover, save in the case of a lockdown arising as a result of a pandemic.

The "OR" in the statement highlighted above may be troubling for the sector - it would be reasonable to assume that there is no mis-selling if the policyholder requested general BI cover (even potentially with relevant extensions for notifiable diseases or a local authority required lockdown) but the policy has limits on how the extension worked or there were relevant exclusions. There may then be questions on the extent to which these terms and exclusions were brought to the attention of the policyholder or were sufficiently clear in the policy. However, the FCA statement appears to indicate that a gap between the policy requested and the extent of cover may be sufficient for a valid claim; although this may not have been intentional. It would seem to be more likely that the validity of a complaint would be based on both the instructions and the information provided.

The likely remedy for any successful mis-selling claim would be the return of the insurance premium to the policyholder, rather than the value of the cover they maintain they believe they were being sold. This is therefore unlikely to be the primary cause of action pursued by policyholders – a successful claim for coverage would likely be significantly more advantageous.

Intermediaries may be in a more difficult position. If policyholders have policy wordings which are determined not to provide coronavirus cover, but the court determines that other policies which were available do provide that cover, policyholders may have a claim against their brokers for breach of duty. The remedy against brokers in such circumstances would be to put the policyholder in the position they would have been had the broker complied with its duty and obtained the intended coverage.

Complaints would likely be made to the Financial Ombudsman Service (if the firms cannot resolve with the policyholder) and there is, of course, the potential for FCA sanction if firms are found to be in breach of regulation.

In any event, this looks to be a significant industry risk and insurers and intermediaries may well want to review and consider their position and how they would respond to any complaints.

Conclusion

It is obviously an understatement to say that the sector is materially impacted by coronavirus and the lockdown. The claims exposure and the impacts on investments are possibly better understood and quantified; the risks highlighted above in relation to compensation for loss of "value" and for mis-

selling are possibly less well understood and are much harder to analyse and quantify at this stage. Only time will tell whether these additional potential limbs are the real sting in the tail.

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