

## Press Release

The true effect of BI insurers' controversial deduction of grants, loans and furlough payments paid by government from taxpayers' money are now resulting in some policyholders still being unable to resurrect their business even after the reduced 'allowable indemnity' is paid.

Whilst the controversial issue has been raised in several industry circles there is, as yet, no conclusion reached because the insurers and loss adjusters simply assert that the prevailing convention is that furlough monies are 'wages' and therefore deductible from the settlement equation.

*"Already, policyholders receiving requests for financial information in support of their BI claim are being told from the outset that the deductions are not negotiable", says Roger Flaxman Chairman of award-winning independent claims advocates, Flaxmans. "It is evidently not in the spirit of the government intentions that insurers make these deductions and it will do nothing to help the dire reputational damage already suffered by our industry to make matters worse for the very policyholders who form the backbone of our industry's future client base. So, we have taken the initiative to set out the cases 'for and against' deductions, of furlough monies in particular, based upon the several views expressed by experienced industry -practitioners and so offer a case for government to consider before the real damage is done.*

## Furlough Payment Deductions – 'Out of Bounds'?

### The Vexing Issue

The Supreme Court ruling on the FCA's test case has thankfully been resolved, broadly in favour of the 370,000 affected policyholders. Next comes the vexing task of 'adjusting' the losses claimed by the policyholders and already some insurers have asserted 'their right' to deduct grants, loans and Furlough monies from indemnity payments. This bulletin examines the controversial question: **Is it Treating Customers Fairly for insurers now to deduct monies that have been paid from taxpayers' pockets to preserve the livelihoods of the nation (including 'prudent uninsured' policyholders) after the insurers have been found to be wrong to have denied payments of bona fide claims for 370,000 policyholders for more than a year?**

### What are Furlough Payments?

A **furlough** is "a temporary leave of employees due to special needs of a company or employer, which may be due to economic conditions of a specific employer or in society as a whole."

The Coronavirus Job Retention Scheme (**CJRS**) is an unprecedented payment by government - using taxpayers' money – "to save lives and livelihoods".

- *For hours not worked by the employee, the government will pay 80% of wages up to a cap of £2,500. The grant must be paid to the employee in full.*
- *Employers will pay employer NICs and pension contributions, and should continue to pay the employee for hours worked in the normal way.*

The deduction of grants and loans, specifically, is contrary to the wishes of John Glen MP economic secretary to **HM Treasury** who has said:

*“It is the government’s firm expectation that grant funds intended to provide emergency support to businesses at this time of crisis are not to be deducted from business interruption insurance claims,”*

He said that the effect of making the deductions was that rather than supporting businesses and protecting jobs during the pandemic ....

*“taxpayer funds are being channelled into savings for insurers”.*

He called on insurers making deductions to ....

*“respect the spirit”*

of the government support schemes and criticised the deduction of payments as being ....

*“clearly not in line with the intention of the support schemes”.*

The **ABI** Director General, Huw Evans had told John Glen that twelve (named) insurers will not be deducting the Local Authority Grant, the Small Business Grant and the Leisure/Retail/Hospitality grants, or their equivalents in Scotland, Wales and Northern Ireland, from any Covid-19 claims payments. Evans commented: ....

*“In the minority of cases where this has already happened, each firm concerned will review these claims and reach out to claimants in relation to adjusting the settlement, accordingly,”*

However, no specific mention has been made of the **Furlough payments** to ‘employed individuals’ whom the government wanted to make safe from redundancy and consequent dependency upon the Social Security system were they to be laid off by their employer for want of money to pay their wages.

**The Financial Conduct Authority** has written to insurers urging them to “consider very carefully the appropriateness of any deductions”.

What does that mean in practice?

## **A Public Interest Debate**

It is clear from the sentiments expressed by government, the ABI and the FCA that they are not in favour of insurers claiming back monies made under the extraordinary emergency conditions brought about by the pandemic; irrespective of ordinary insurance conventions that preclude a policyholder from profiting from a contract of insurance. However, already some insurers are deducting grants, loans and Furlough monies; others are not. Once again the industry is failing to meet public expectation of consistency and reasonableness of approach. This will not go unnoticed and should not go unremarked.

In the interests of the British public and the future reputation of the insurance industry this paper sets out the arguments advanced by some of the industry’s experienced insurance practitioners ‘for’ and ‘against’ deduction of Furlough monies from BI insurance claims.

## **Insurance Experts’ Opinions**

A sample of experts’ opinions on the question of deduction, *or not*, include the following headings:

### **For Deduction:**

1. **“Ordinary insurance law and practice must be preserved to protect the future of the industry.”;**

The ordinary practice, is for any income or revenue received and savings made by the ‘damaged’ business to be deducted from any indemnity afforded by the policy. This must not change for the present Covid claims.

2. **“Traditional loss adjusting practices are obligatory and should not be disturbed for one class of loss (i.e. the consequences of the pandemic/ lockdown).”;**

There are no grounds for diversifying from ordinary, traditional loss adjusting conventions. Any derogation from traditional conventions would serve to undermine their future power of rigorous control of the insurer’s obligations and remedies in the settlement of claims and damage the future profitability of the industry.

3. **“A policyholder must not be permitted to gain from their loss and Furlough payments in addition to indemnity would constitute a ‘windfall’ benefit.”;**

Some industry practitioners say that Furlough payments constitute either income or revenue and have already or will contribute to the recovery of the business from its loss. Therefore, such Furlough monies as are received shall be deducted from the indemnity otherwise provided by the policy to prevent the Insured from profiting from the policy of insurance.

4. **“Alternatively, Furlough payments should be deducted from the Business Interruption payments and such monies returned to HMRC via tax adjustments.”;**

Insurance companies should be able to benefit from the deduction and retention of the Furlough monies to protect their profits in unprecedented times and later account for it to HMRC through future tax adjustments.

#### **Against Deduction:**

5. **“The Furlough payment plays no part in preserving the future of the business or promoting its recovery. Furloughed employees have no influence or say in the future destiny of the business by reason of having received the Furlough monies.”;**

Furlough monies are not revenue, income or a saving. It is a ‘humanitarian payment’ by government via employers (insured or not) to prevent the termination of employment which would send hundreds of thousands, possibly millions into Social Security system and the attendant consequences of mass unemployment at the time of a national crisis.

6. **“The Furlough was provided to all businesses, whether insured for BI or not. Those prudently insured should not be prejudiced for their foresight.”;**

The CJRS is an arrangement between HMRC & Employers. Every qualifying business is eligible for the CJRS payment to its employed individuals. Conditions

were imposed upon the Employer, which then entitled the Employer to claim the amount of furloughed wages from HMRC, in turn providing the cash-flow required for the Employer to distribute its payroll, either for 80% or up to 100%, if the business was able to make up the difference. The payroll followed normal practice of PAYE, NI & Pension deductions. The payment to the business, was paid in arrears by HMRC.

No business or employed person will be required to repay the monies to government. Employees agreed to vary their contract of employment to receive the Furlough payments.

It is not reasonable that an insured business should be required to repay the money to an insurance company, for its executives and shareholders to profit at the expense of taxpayers.

**7. “The Furlough monies went straight to the employee and made no difference to the sustainability or recovery of the business itself.”;**

The Business was not able to use the Furlough monies for any purpose of mitigating the loss to the business or promoting recovery of the business.

Ordinarily in a BI claim the wages would be paid in conjunction with other costs and expenses necessary to keep the business alive whilst the repairs are carried out and the business gets back to trading, as before. Insurers failed to honour that bargain in the case of the Covid Lockdown and so cannot now turn the clock back and have the Furlough money as well as having deprived the Insured proper and timely payment of their claim.

Furthermore, in the case of Furlough monies the ‘wages’ were paid in isolation and therefore of no equivalent value to a proper BI indemnity payment because on their own they could not assist in keeping the business alive. For that reason they fall outside the ordinary context of being income revenue or a saving to the business.

### **Objectives of Furlough**

It is broadly agreed amongst consulted insurance experts that the overarching objective of government was / is to sustain humanitarian life support and safety to individuals in their personal capacity not as an ‘employee’ per se of an employer’s business. The Business was/is a mere conduit for the safe and measurable payment of the monies.

CJRS was designed to prevent employed people from redundancy thereby forcing them into Social Security system where the government would be responsible for 100% of the cost of preserving lives and livelihoods. It is specifically aimed at supporting the lives and livelihoods of people already in employment and not for any other purpose connected with an employer’s business or supporting a business.

It is recognised as being more difficult to find employment once made redundant and so the retention of the employee in a place of employment with at least a prospect of returning to work was / is in the best interests of the employees, the employers and ultimately the public interest.

Paying employees through an established PAYE system was deemed both practical and safe ensuring as far as possible that the money goes to the right person for the right reason.

## Indemnity of the Business

The insurance policy is a contract to indemnify the business against the loss sustained by the insured peril/s. Its purpose is, in practice two-fold:

- a) To provide interim payments to the business in order to protect cash flow and thereby mitigate the loss and promote recovery of the business following the interruption to its ordinary course.
- b) To pay (indemnify) the business for the capital and additional costs of reinstating the business to its pre-loss operating profitability.

The industry has in this case broadly failed to deliver the indemnity to policyholders and that has caused them to rely upon the government.

### The Essential Issue - No parity of Loss – Non comparable circumstances

Government emergency grants, loans and Furlough payments have no parity with a contract of indemnity. Their purpose is entirely separate and distinct from the purpose of a contract of insurance.

In the context of BI insurance the ordinary dynamics of a single business suffering a loss in the midst of an otherwise unaffected community are entirely distinct and different from the dynamics of an entire community affected by the same 'peril' at the same time as is the consequence of the Covid 19 pandemic and lockdown. The resultant claims must be treated differently from the ordinary, isolated BI claim.

**Ordinarily**, a business suffering a loss by an insured peril is typically just one business alone in the midst of a community of businesses that have not suffered at all at the same time. The fire damaged or flooded business alone in the midst of the community, can reasonably expect to get up and running again with the financial help of BI insurers. The damaged business and the nature of the business remains as relevant to the community it serves after the loss as it did before the loss and so the status of the business can be expected to resume as before the loss provided the business can be supported by the comprehensive BI insurance payments through the process of reinstatement and recovery.

Consequently, there is a reasonable prospect of recovery after a loss such as to be able to resume in the same manner and profitability as prior to the loss. That is the basis upon which the rationale for Business Interruption insurance is sold. That status does not pertain to the present all-embracing Lockdown Covid 19 pandemic crisis.

**Extra-Ordinarily**, the circumstances of the Coronavirus pandemic present an entirely distinct and different context for the application of insurance practice and conventions.

Every business in the affected 'area' has suffered from the same 'peril/s' at the same time thereby destroying the infrastructure of a community of businesses. That fact changes every other dynamic ordinarily present in the adjusting of an insurance claim.

Consequently, in the ordinary case of a BI loss the retention of employees to 'pick up where they left off' had a purpose for which the payment of wages, *in conjunction with other costs and expenses* was essential to preserve the integrity of the recoverable business. The same does not apply to the Coronavirus pandemic circumstances where there is now often no reasonable prospect of employees 'continuing as before' and the business fitting back into the business community in the ordinary way. The business community is suffering as a

whole for reasons of wide area damage and there is no ordinary BI adjustment convention to deal with it.

Consequently, the government's 'humanitarian lifeline' to otherwise potentially unemployable employees in the form of the unprecedented 'Furlough scheme' is clearly outside any insurance market custom or practice or precedent of 'income revenue or savings' that can justify the reclaiming of the Furlough payment in the adjustment of a BI loss. Therefore, the industry is at liberty to ignore Furlough payments in the adjustment of Covid claims; and arguably it should do so.

### **Deduct and Repay to Government**

It has been suggested by some insurance industry commentators that the Furlough monies should be repaid to insurers (by deduction from the indemnity) and that insurers should then repay the monies to government. This suggestion is not as straightforward as it at first seems and is almost impossible to achieve.

**Firstly**, government has expressed no intention of reclaiming such monies; and it would find it time consuming, costly and difficult to achieve.

**Secondly**, the monies are now in the hands of the employees, and spent; and there could be no question of reclaiming it, even if it had ever considered doing so.

**Thirdly**, the employers do not have the equivalent amount of money to repay to anyone without the risk of bankrupting the company. To bankrupt businesses is not in the best interests of the government; neither is it in the public interest.

It follows that if government can mitigate the risk of millions being unemployed and dependant upon Social Security by providing money to the individuals that rely upon employment for their ordinary living, then the Furlough has a sacrosanct place in the management of the Covid crisis and should not be prejudiced by the insurance industry for its own (or shareholders') benefit.

### **Insurers' Obligation to Serve**

The insurance industry should not be encouraged by government or trade bodies to dislodge and compromise the recovery of the post-Covid economy by reason of protecting itself or its shareholders before it protects the community it is intended to serve.

The fundamental purpose of insurance is to provide a reliable, trustworthy and affordable source of money to protect the 'policyholding community' from the ravages of fortuitous events over which policyholders have no control and for which, without insurance, they have no means of recovery.

Insurers volunteer to put their (shareholders') money at risk to serve the community with the invaluable contract of indemnity that is an insurance policy. That objective should remain the priority and not be subjugated to a secondary objective of enriching themselves and their shareholders at the expense of the community for which insurance exists.

### **Shareholders' Vote**

The priority right now is to get businesses back in harness and growing the economy as quickly as possible. Anything that the insurance industry does to inhibit or prevent that objective will attract the opprobrium of the insuring public. Why would the industry want to do that? Would their shareholders vote to enrich themselves before they rebuild the community upon which, on every ordinary day, they will soon rely?

## Government's Obligations

Government has an obligation to serve the best interests of the electorate / the community and its best interests are served by protecting absolutely and without exception the grants, loans and Furlough monies from any interference or intervention by commercial entities of any kind for any reason.

Government Treasury and HMRC should arguably now decree that ALL forms of financial assistance received by businesses are "out of bounds" for the purpose of claims adjustments (deductions) by insurers.

Alternatively, say some commentators, the Treasury and HMRC could impose a "windfall tax" on businesses for the actual amount received in payment of the payroll element of their claim. The business would be required to declare such amount as part of their annual tax return.

It is also argued by some interested parties that if the employer did not "top up" the employees' wages, (the twenty percent difference) such amount would be required to be paid to employees as "back pay" from the time they had an enforced pay cut.

## Insurers - 'The Great Escape'

some of the insurance industry's leading companies have been 'found wanting' by the Supreme Court and are now required to pay claims that they had pleaded were not covered by their various insurance policies.

Can it be, ask other insurance practitioners affected by this decision, that a responsible government permits the relevant insurers to even now escape liability as determined by the Supreme Court by means of 'reading down' the judgment and invoking complex technical 'adjustments' of the policyholders' claims, which are incomprehensible to what the Supreme Court has described as the 'ordinary person'? To allow this would surely amount to a contempt of court, putting the industry beyond the power and scrutiny of the law.

If insurers had responded as they should have done in late March early April 2020, these businesses would have been receiving interim payments in the ordinary way in which business interruption claims are managed and the much needed cash-flow would have largely solved their problem. Had that occurred the insured businesses would already be better positioned to serve the economy when lockdown-release permits.

In fact, those insurers which have now been shown by the SC to have a liability to pay claims, have failed to support their policyholders in their time of need. The time to supply the essential financial support was at the time the businesses had suffered the interruption, not nearly a year after the event.

Should the delay in being indemnified be permitted to be exacerbated by an artificial, retrospective and theoretically doubtful 'loss adjustment' that will only serve to negate the purpose of the government support; and also alienate the SME insuring community?

As an experienced insurance practitioner said in interview ***"If the industry had indemnified its 370,000 policyholders they would not have needed to furlough employees or therefore to draw on the furlough monies; and saved the taxpayer the cost."***

## The Industry's Reputational Legacy - and Future

It is, from the views expressed by many insurance observers, reasonable to predict that it will not assist the regaining of the public trust in the insurance industry if insurers claim the

Furlough monies to defray the costs of their own losses. Whilst there will be counter-arguments by insurers that they have *'a duty to keep down the cost of insurance for policyholders as a whole and must also satisfy shareholder demands and expectations'*, those arguments are not likely to fan the enthusiasm of the general public towards the industry. Already, insurance premiums are being increased by incredible proportions and the logic for that has also escaped the general insuring public.

Shareholders of socially responsible insurance companies would be unlikely to publicly vote for their investment to be enhanced by the re-claiming of Furlough payments from the community.

Perhaps the best advertising spend of the industry in 2021 year will be to acknowledge the government's message to "respect the spirit" and concede that Furlough payments are **'out of bounds'**.

**It is evidently in the best interests of the British public and its economy, presently and going forward, that Government should now speak up and speak out against the insurers disregarding *"..... the government's firm expectation that monies intended to provide emergency support to businesses at this time of crisis are not to be deducted from business interruption insurance claims. That is clearly not in line with the intention of the support schemes"*.**

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