

Good afternoon – I think it is afternoon for all of us – ladies and gentlemen. Thank you for inviting me to speak to you today. Lizelle has often attempted to bully me into coming to South Africa – something Mrs C is reluctant to do as she is a New Zealander and seems to have some beef with you over rugby or something. So I am glad that I have made it to your fine country finally – albeit only virtually.

I should probably start by saying a few words about LIIBA and what we do. We are the trade association for Lloyd's brokers active in the specialty markets in London. You have to be a Lloyd's broker to be a LIIBA member – although, somewhat distressingly, you do not have to be a LIIBA member to be a Lloyd's broker. That said over 98% of Lloyd's brokers are members measured by premium volume. Our members bring \$110 billion of premium to London every year from an international client base. Less than a third of that comes from UK clients with North America being our biggest market. It is predominantly large, complex commercial business or what I like to call the glamorous end of the insurance industry.

That focus on international markets makes us at LIIBA unusually nose-y about what people are up to in other countries and it is that global perspective on the industry response to Covid-19 that I have been asked to focus on today **{next slide}**

I thought I would do this in the context of the various failings of business interruption insurance we have seen in most countries – and some personal thoughts on where that leaves the insurance industry in the eyes of our clients. And then I will move on to look at the various attempts at designing public/private solutions that could allow insurance to respond more positively to future systemic events. **[next slide]**

The first thing to say about business interruption insurance is that, by a general rule of thumb, about 95% of contracts in most countries have clear and unambiguous exclusion clauses for

infectious diseases and clearly should not pay out. Whether or not the businesses buying such interruption insurance knew this is a different matter entirely and I will return to that question shortly. But that leaves a limited number where it is not clear whether a claimable event has occurred.

And in these cases, in general, we have three areas of dispute. Firstly, has the alleged loss been directly caused by the spread of the virus or is it in fact the various government pronouncements that led to business closure – and is that a relevant distinction to make.

Whether those government pronouncements were of sufficient force to represent a denial of access to business properties and finally what the right counterfactual is to calculate the losses businesses have suffered. With that as the battleground we have seen various approaches to resolving these disputes in recent months. **[next slide]**

I am going to start with the test case process embarked upon by the Financial Conduct Authority here in UK. And I am doing this not just because I live here and it is the response I know most about making it easier for me to major on it. Although that is a significant driver obviously. But I also think it is an interesting activist approach by a regulator designed to provide clarity for clients as quickly as possible. And I know that it is an approach that the global industry is watching with interest as well as other regulators – and in Australia they have subsequently embarked on a similar process.

It is probably worth a little background as to how we got to this point. Back in the early days of lockdown – which began on March 16<sup>th</sup> for us – I sat in on an industry call with FCA during which the regulator challenged the insurers to find a path to provide clarity on ambiguous BI policies that did not involve lengthy litigation during which the client would go bankrupt. Fast forward about two weeks and FCA announced that it was proposing to pursue test cases to resolve the issue.

This action is being taken under the Financial Markets Test Case Scheme - a legal framework created in 2005 to provide a method of rapidly reaching legally binding judgements on all firms directly involved in the cases and a judgement that should have a material impact on similar cases involving other firms. This is the first time the scheme has ever been utilised. A fifteen year wait to validate it was a good idea.

FCA asked clients and brokers to submit wordings from contracts that they felt were ambiguous. They then grouped these into the areas of dispute I covered earlier. 17 clauses are the subject of the actual litigation but the judgement will cover around 75. We have 8 insurers on one side and FCA plus two class action groups on the other, The case has involved 8 days in the High Court and the judgement is expected in the middle of next month. After that there is an expedited appeal process to our Supreme Court. Although it is to be hoped that insurers finally see sense and do not appeal if the outcome is that they have been sued by their regulator and lost.

I may have already given away too much of my personal feelings on these cases – and I should emphasise they are personal, LIIBA is not taking sides in this save to say that, as brokers, we always want the best possible outcomes for our clients. But I would summarise the arguments that were laid before the courts as follows. FCA's position is that any loss has been directly caused by Covid-19 because, frankly, we would not have been doing any of this stay at home nonsense if the virus did not exist. It further contends that, as the government is the highest authority in the land, if it tells you to stay at home you are compelled to obey. It doesn't matter whether it is technically guidance or an instruction or something backed by legislation, they have said jump. And finally FCA argues that the relevant scenario to calculate losses is what would have happened if there had been no virus and businesses had continued to trade normally. All perfectly sensible and logical positions which will make complete sense in the more important court of public opinion.

The insurer counter can be seen as follows. It wasn't the virus that caused everybody to stay home it was a combination of government suggestion and public panic. The stay home message carried as much weight as government campaigns to get people to eat five portions of fruit and vegetables a day (they seriously said this). Everybody was at perfect liberty to keep their businesses open. But had they done so, nobody would have turned up in the shops and restaurants involved as they were all staying at home and so no-one has lost anything anyway. To my mind stark staring bonkers arguments that will make no sense at all to the wider public to whom insurers may wish to sell products in the future. Indeed if an industry that is perceived by much of the public as constantly pursuing obscure legalistic arguments to avoid paying claims had wanted to embark on a process of confirming that perception, it could hardly have done a better job. Obviously we will have to await judgement but, and I will return to this point in a moment, the long term reputational damage to insurers could well be severe. **[next slide]**

Elsewhere the trend thus far where disputes have come to a head has been to veer towards the insurer – particularly in the States. But I have picked out a few exceptions here. Axa lost a case brought by a Parisian restaurant owner as the court decided that the French government action was sufficient to constitute denial of access. Similarly the Higher Court in Manheim has ruled that German federal action also meant insurance should respond – although there are differing judgements around whether contracts that refer to a specific list of infectious diseases but also reference the legislation in Germany that maintains the list of infectious diseases should pay out – basically a question of whether or not Covid-19 specifically was covered. In Bavaria where a state solidarity fund meant that 70% of business losses were covered, Allianz and other insurers have agreed to cover half the difference (ie 15% of the total loss) as a good will gesture (although the general public reaction was “why aren't you paying the other half”).

And in US, the District Court for the Western District of Missouri Southern Section has bucked the trend of other judgements by accepting that the claimants - Missourian restaurant owners - have established a physical loss that their policies should cover. But US being US there are around five levels of court to go before this actually could come to fruition sometime during the Presidency of Dr Dre who will succeed Kanye West after his two terms in office. **[next slide]**

So, where does all this leave us? I think we need to look at several things. Insurance language is opaque. We talk of policies when we should talk of contracts – and maybe people would be more incentivised to read a contract and understand what it means. We talk of wordings and people think “what?” I even would take issue with the word claim – which sounds like something you have to make an effort to get at. Rather than compensation – which is something to which you are entitled. Fundamentally if a business purchases business interruption insurance and its business is interrupted only for it to find it is not insured the main part of the problem in the long run is on the insurance industry not its, no doubt former, customer.

As I may have alluded to already, I think that the FCA test cases have exposed the fact that a number of principles of insurance just don’t stack up to public scrutiny. And it is the public that you need to want to buy insurance and so that is not a good place to be. UK insurers needed someone in the room who could have witnessed them constructing the defence that Covid-19 wasn’t the cause of businesses shutting and that no one has lost anything and whose job it was to say “can you listen to yourselves???” I am sorry but concepts like proximate cause and the but for principle just sound nuts to our customers. If that is the only way products can be designed we are all in trouble. There must be a better way. I think we need to fundamentally rethink products and make sure they are designed with a view to paying valid claims not avoiding them. **[next slide]**

So there is a reputation to rebuild. You may notice that all through this I have avoided saying things like “we have a reputation to rebuild” and that has been very deliberate. I think as insurance brokers we do need to distinguish ourselves from the insurers sometimes in the minds of politicians and regulators. It is insurers that have behaved badly in this crisis. In the main we are the good guys on the side of the client.

The chance to enhance reputations may come from designing insurance solutions to systemic risk that have a chance of responding better to future events. Much work is going on around the world to look at this – of which more in a moment. But I thought I would just touch on the key questions to answer in these discussions.

The key principle is that the private sector alone cannot provide the sorts of capacity required. In UK annual turnover of SME businesses is £2.2 trillion. Which is quite a lot and beyond the scope of the insurance industry to cover. So an element of public backstop will be necessary. But the incentive for governments to participate is that any private participation in the schemes will lower the bill to the public purse – and, as they will hopefully realise, the insurance compensation process is a far more efficient means of getting money to the right people fast than bank loans.

The design then becomes a series of trade offs. If you define the circumstances in which you expect claims to be triggered reasonably tightly then you have more scope for more accurate modelling and the greater insurer confidence that will develop will expand the private sector role. But the risk is you define away the cause of the next crisis. So should these be pandemic only solutions or are they better to be loosely defined black swan event cover is question number one.

Then there is the question of what should trigger payment. An automatic trigger – say a government declaration of an emergency or a trigger based around some index of emerging

economic and societal loss – will get payments to people quicker than if they have to establish an actual loss. But it may not get the right amounts to the right people and thus be a less effective response.

Similarly waiting to establish an actual loss will delay payment but make it more accurate, whereas basing payment on a proxy like a percentage of a firm's costs will make the process quicker but may mean some are not sufficiently compensated to survive.

Do you make the assumption that big firms can look after themselves and you should only compensate SMEs or is that too big a risk given the economic consequences if you are wrong?

Do you make purchase of the product or the extension optional – risking that people won't buy it either due to cost or the moral hazard that they think government will step in anyway – or do you make it mandatory, potentially risking your businesses being lumbered with a cost that makes them uncompetitive in international markets?

And, finally on this list, but I am sure there are a myriad of other relevant questions, is how do you ensure your solution has the sort of parametric trigger that tends to be the feature of ILS products and this attracts the \$1.3 trillion of capital already in alternative investment schemes? Because we need access to as much private capacity as possible for these solutions to be viable

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These are the questions being pondered around the globe. In France they are probably as advanced as anywhere. A working group set up by the Ministry of Finance and which included our colleagues at Planete CSCA produced a paper at the beginning of June which is currently out for consultation. They concluded a preference for tight definitions, restricted

but automatic triggers, losses based on a percentage of costs and to cover all businesses but possibly with a separate scheme for SMEs. Let us see how that is reacted to.

In Germany they have only just agreed the composition of their working party and discussions are just beginning. They are the two remaining EU powerhouses who might provide the backbone of a Union wide response. The potential for that was set out in an EIOPA (EU regulator) staff paper – not an official document. This envisages four levels of security with the private insurance and then reinsurance sectors being backed first by national governments and then by EU itself. We contributed to the consultation on this paper via BIPAR – our European federation. Once we had got past the fact that much of the proposal just seemed like a massive grab for data, the key issue was how to ensure a sufficiently consistent response across EU member states. EU has seen most countries in strict lockdown, but Sweden in hardly any lockdown at all. In those circumstances how should any EU compensation be distributed?

In UK we have a working group led by Stephen Catlin which is in discussions with government. But this is a government that currently seems to have an inability to think beyond its next press conference, so progress may be slow.

Lloyd's also published a white paper on possible solutions. It is looking at three things. Restart – which would provide capacity to cover a second wave of the virus. Recover – a possibly 25 year policy which would provide cover of Covid claims with the ability to recoup those losses over the term. And Black Swan Re which would be where the French would end up if they went for looser definitions. Lloyd's aim here is not to actually deliver any of these solution anywhere but rather to co-ordinate the expertise available in London and to partner with academia to develop a framework that national governments could use to take forward their own proposals. I know FIA have met with the Lloyd's team to discuss in more detail.

And so to US where there are three proposals doing the rounds on Capitol Hill. They are all mainly based on a pandemic version of the existing Terrorism Risk Insurance Act. One is being promoted by Evan Greenberg and Chubb; one by Zurich and the third I am not allowed to call the Marsh solution because they don't like it being described as such. The main difference tends to be the level of public participation proposed which ranges from infinitesimally small to tiny. There is a roundtable meeting scheduled for 10<sup>th</sup> September to try and resolve issues and produce a consolidated approach that could be introduced into the House in November in legislation sponsored by Carolyn Maloney the Democrat Congressional representative from New York's 12<sup>th</sup> district. You did not really need to know that, but I had an opportunity to make this sound like an episode of the *West Wing* and I took it. This bill would not pass the current Senate but could provide the basis for a solution to be agreed if a Democrat wave puts Joe Biden in the White House and Democrats in control of both houses of Congress. Which could happen. Or not.

So, a very quick canter through how our global industry is reacting to Covid-19. Thus far badly – but that is the fault of insurers and not brokers. Now is the time to make sure that the longer term judgement is a little bit more favourable than that. Thank you.