

Financial Regulatory Alert

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Update on the FCA's Test Case on Business Interruption Insurance

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On 1 May 2020, the UK Financial Conduct Authority (FCA) issued a **statement** announcing its intention to obtain a court declaration to resolve contractual uncertainty in business interruption (BI) insurance policies. Further detail has been provided by the FCA on 1 June 2020 and this will be of particular interest to investment managers that have investments in companies that have BI insurance policies or investments in insurers that provide this type of insurance; the consequences of a court ruling, one way or the other, will undoubtedly have significant cost implications and affect the profitability or viability of investee companies.

The unprecedented decision to pursue a 'test case' before the High Court arose due to continuing, widespread concerns regarding the lack of clarity and certainty for customers seeking to make BI claims and, specifically, the basis on which certain firms were making decisions in relation to those claims. Subsequently, on **15 May 2020**, the FCA invited policyholders of BI insurance who were in dispute with their insurers over the terms of their policies to send the FCA their arguments in order to be taken into account in the proceedings. Most recently, on 1 June 2020, the FCA **announced** that it had identified the representative sample of policy wording to be examined in the test case, the insurers using those wordings, and the initial list of insurers who had agreed to participate in the proceedings. It is expected that the FCA's test case will be heard in the second half of July 2020. We highlight below the background to the FCA's test case and the implications of such an interventionist approach by the UK regulator.

Background to the FCA's 'test case'

The test case comprises what the FCA believes are key relevant cases that will provide the greatest clarity on specific policy clauses and will be "carefully chosen as a representative sample of the most frequently used policy wordings that are giving rise to uncertainty". This is a significant example of the FCA adopting a proactive, interventionist approach to resolving uncertainty and seeking to pursue legal action in the public interest in order to advance the objectives of consumer protection and market integrity. Notably, however, the test case is not intended to determine how much is payable under individual policies nor will it prevent individuals from accessing the Financial Ombudsman or pursuing issues through the courts (should they qualify

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and wish to do so)—though any declaratory judgment obtained may be taken into account by the Financial Ombudsman when considering relevant complaints.

In its announcement on 1 June 2020, the FCA provided a non-exhaustive initial [list of insurers and policy wordings](#) (reflecting the 17 policy wordings within the scope of the test case), together with the [proposed assumed facts](#) for the purposes of the proceedings (including the nature of the affected businesses and how they have been affected by the pandemic), a [proposed issues matrix](#) and [proposed questions for determination](#) by the High Court. This latest announcement follows the FCA's review of over 500 relevant policies from 40 insurers. The FCA's list of affected insurers is not comprehensive, however, and there are other insurers and other policies in the market that are likely to be affected by the test case. Insurers, policyholders and other intermediaries have been invited to comment on the FCA's latest set of documents by 5 June, and the FCA's legal advisers have offered the opportunity to speak directly with policyholders and intermediaries.¹ In the interim, the FCA has further published a short [consultation on draft guidance](#), requesting all insurers to check their policy wordings against those in the test case to identify if their policies would be impacted by the outcome of the case. It is expected that the FCA will publish an updated, consolidated list of disputed BI policies in July.

The FCA's decision to pursue a test case has followed from an earlier [Dear CEO letter](#) issued to all chief executives of insurance firms, outlining the FCA's expectation of firms with regard to the settlement of BI claims and the need to assess and settle such claims quickly. Underpinning the FCA's actions is the desire to ensure firms consider the needs of their customers and act flexibly in their treatment such customers; this attitude had previously been reflected in the [FCA's guidance](#) for insurance firms in the context of COVID-19, issued on 19 March 2020.

What are the implications?

The issues surrounding BI policies are complex, in part due to the variations in the types of cover provided and wording used. This has resulted in "genuine doubts over appropriate interpretation" of policy wording, particularly for small to mid-size enterprises (SMEs) (which the FCA had previously noted were unlikely to have insurance policies obliging insurers to pay out in relation to the COVID-19 pandemic). This uncertainty has been exacerbated by the major disruptions in the insurance sector caused by the COVID-19 pandemic. Many BI claims may already be the subject of negotiation or other dispute resolution processes, and the FCA's proposed action is not intended to impact the normal claims process. Instead, any declaratory judgment obtained will likely assist policyholders and will, significantly, be legally binding on the insurers that are parties to the test case in respect of the representative sample considered.

The results of the test case will further provide persuasive guidance for the interpretation of similar policy wordings that may be taken into account in other court proceedings (including in Scotland and Northern Ireland), by the FCA when assessing whether insurers are handling claims fairly, and by the Financial Ombudsman Service. Indeed, the representative nature of the policies and wordings selected by the FCA suggest that many other BI policies (not in the representative sample) will also be impacted.

The pursuit of the test case before the High Court is clear recognition by the FCA that current circumstances, heightened by the COVID-19 pandemic, have given rise to significant uncertainty and risk for insurers and policyholders; it is anticipated that the test case will go some way towards addressing such uncertainty. The test case is further reflective of the FCA's proactive approach to ensuring market stability.

What next?

The High Court ruling is expected in the second half of July, following a proposed 5 to 10 day court hearing. Investment managers with investments in companies that have BI insurance policies, or otherwise have investments in insurers that provide BI insurance, should keep a close eye on the outcome of the High Court ruling as the cost implications, which may affect the profitability or viability of investee companies, may be significant. The FCA has established a [dedicated webpage](#) where it will provide information, updates and access to documents, including court documentation, and a [form to sign up for updates](#) on this matter.

We will continue to monitor developments in this area.

¹ The FCA has further developed a [Policyholder Engagement Statement](#) for policyholders and insurance intermediaries, setting out the FCA's approach to the High Court test case and confirming the FCA's intention to consult with policyholders at key stages in the test case and make all the 'pleadings' public.

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