Brexit, Covid-19, and its impact on underinsurance

BUSINESS INFORMATION UPDATE FROM ETHOS BROKING

AUGUST 2021

While Brexit and covid-19 have led to supply chain issues and adapted business operations, the insurance implications of these are often not taken into account. Make sure that you and your business don't fall victim to the dangers of underinsurance.

BREXIT EFFECTS ON CONSTRUCTION AND OPERATING COSTS

With the UK no longer being a member of the EU, a major source of materials and labour has been adversely affected. Acquiring these and selling to foreign markets now come with a new set of bureaucratic rules, regulations, and red tape (not to mention, increased costs).

SUPPLY OF RAW MATERIALS

While the UK is becoming more self-sufficient, its strong exchange rate, history of expansionism and more recent economic ties to Europe have made the import of both raw and finished goods a massive part of its supply chain. For example, the country usually gets most of its horticultural products, petroleum products, steel, and cement from the continent.

During the financial crisis of 2008, a lack of access to cement, as well as the ceasing of many construction projects, led to the closure of countless brick manufacturing plants. According to Rebuild Cost Assessment; "a few years later, when construction work started to pick up again, there was a significant shortage of bricks. Low supply and increased demand meant that the cost of bricks sky rocketed. Data from RICS' Building Cost Information Service (BCIS) shows brickwork costs went up by as much as 26% in 2014 alone, with a 40% increase in the past four years." More recently, in 2021, bagged cement was hit by additional shortages and increased demand after the easing of covid-19 restrictions, leading to its **price rising by over 15%.**

This drastically affects the cost (and therefore, the value) of construction projects, including that of residential properties. "The House Rebuilding Cost Index for example, which is widely used by insurers to make annual revisions to sums insured, is based on an average of house types". It is therefore vital to regularly check rebuilding costs in order to avoid the risk of underinsurance.

Past economic recessions are just a small-scale example of what could be expected with Brexit. A lack of materials, increased costs, and new regulations could result in the price of materials soaring to new heights. To add insult to injury, the effects of the covid-19 pandemic has led to mass closures of manufacturing plants, mills, and mines – temporarily and some of them permanent.

This phenomenon has already been seen in the steel industry. Germany, Belgium, Spain, and the Netherlands are all major exporters of steel to the UK, with hundreds of millions of pounds being spent on it annually. Supplies have been limited since 2020, with British Steel temporarily stopping orders of structural steel due to "extreme demand". This had led to backlog in orders, inflated costs, and, according **to Fortune,** a staggering price increase of over 200%.

Another consequence of Brexit and repeated lockdowns is the likelihood of businesses to stockpile. As stated by **You Talk Insurance,** "stockpiling has been on the insurance industry's radar for some time, as concerns about the availability of goods from the EU resulted in some businesses increasing the level of stock they held. Taking this action may safeguard the business if issues arise around supply chains but it is also essential that this additional stock is taken into account when arranging insurance".

Concerns over supply chains may also need to be factored into indemnity periods. If it takes longer than expected to acquire stock, equipment, or machinery, it may delay business operations. It is important to take this into consideration when setting the indemnity period on business interruption cover.

SUPPLY OF LABOUR

According to the **Office for National Statistics,** there were an estimated 2.31 million EU nationals working in the UK in 2019, as well as 1.34 million non-EU nationals. Most of these come from Poland, Romania, the Republic of Ireland, Germany, Italy, France, Lithuania, and Portugal. This represents roughly 8% of the UK's working population, with many employed in the construction/manufacturing, restaurant, and hospitality industries. Ironically, these are the same sectors that saw some of the biggest losses during the covid-19 pandemic.

New Brexit regulations have meant that many EU nationals have chosen to return home and has led to a **substantial fall in immigration to the UK.** Much like materials imported from the EU, this had created a reduced supply of labour, and thus, increased costs. A reduced workforce, number of qualified staff, and increased wages (to meet demand) needs to be factored into the level of business insurance required.

Furthermore, the effects of covid-19, paid wages, employees on furlough and benefits have to be considered – both in the short-term and the long-term. "Having a business closed because of lockdown, or with most of its employees on furlough, will drastically affect figures now, but perhaps not as we go forward," says Alastair Blundell, head of insurance at the British Insurance Brokers' Association. It is therefore vital to reassess wage and turnover figures where these need to be declared to insurers.

THE EFFECTS OF LOCKDOWN ON PROFIT (AND VALUATION)

Size, profit, and valuation have a direct effect on the level of insurance that a business requires. While Brexit had bred uncertainty around supply chains, labour and regulations, covid-19 has had a more sudden impact on operations. Businesses have been forced to adapt and reduce expenses (even if only in the short-term), leading to large-scale underinsurance.

REDUCED INCOME (AND BUDGETS)

The most obvious knock-on effect of the covid-19 pandemic is the loss of income to businesses. Many were forced to close, downsize, or cut costs during lockdown. And, when it comes to cutting costs, insurance budgets are often the first to go. In addition to this, the uncertainty and insecurity around operations makes it challenging to assess the amount of insurance that is needed. An example of this is the level of stock required, potential stockpiling and if contents are adequately insured. However, uncertainty is especially pertinent for covers such as liability and business interruption costs, where limits are based around financial data, including turnover, profit, and payroll.

According to **You Talk Insurance,** "if, during the pandemic, a company has not performed as well as it has previously, it may have reduced its sums insured in line with current performance. But, with the economy predicted to grow again, resulting in an increase in sales, the company needs to ensure its sums insured reflects this. Otherwise, there could be a shortfall when the time comes for them to claim."

REINVENTION (AND REVALUATION) AS A CONSEQUENCE

The effects of covid-19 have had a huge impact on how businesses have operated during various levels of lockdown. In order to simply survive, many have adapted their business models, but often without considering its insurance implications. Examples are sit-down restaurants that moved to home deliveries and 'brick and mortar' retail stores that moved to online channels.

While resourceful, these shifts will have an effect on risk and insurance requirements. "For instance, where restaurant staff are delivering food, are their vehicles insured for that purpose? And where a shop goes global by being online, **do they have sufficient liability cover** if something goes wrong with one of its products overseas?" The latter is especially pertinent given the new Brexit rules, regulations, and red tape regarding trade with the EU.

THE CATCH 22 OF UNDERINSURANCE

The 'catch 22' of both Brexit and the covid-19 pandemic is that decreased profits, increased costs and more uncertainty have led to businesses either cutting their insurance budgets or adapting to a point where they're not adequately covered. And, in a time of such crisis, insurance is more important than ever. Taking out less than is needed can have severe long-term consequences that can jeopardise the future of the organisation, its employees, and the public at large if liability claims can't be settled.

Despite this, underinsurance is still incredibly common, whether in times of crisis or not.

ethos broking