PAYING A PREMIUM?

Reforming the insurance market to work for small firms

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WHO WE ARE

The Federation of Small Businesses (FSB) is a non-profit making, grassroots and non-party political business organisation that represents members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

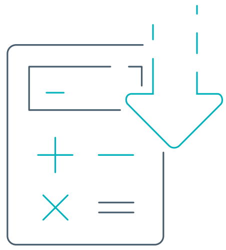
Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and England policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with Governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

PAYING A PREMIUM?

REFORMING THE INSURANCE MARKET TO WORK FOR SMALL FIRMS

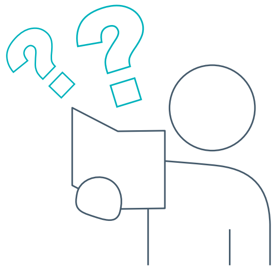
16%

of small businesses say their **premiums have increased** by more than **25 per cent** in the last 12 months



24%

of small business owners report that the **premium increases** have led them to **assess and/or reduce their expenditure**



30%

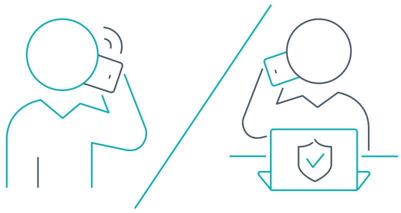
of small businesses say that they find it **difficult to understand what their policy offers** in relation to each of their **business risks/activities**

16%

of small business owners say that their **cover has been restricted** (e.g. higher excess or a lower indemnity limit)

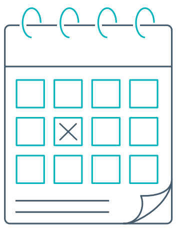
13%

of small businesses say that their **cover has been reduced** (e.g. flood or other type of event cover withdrawn)



69%

of small businesses **purchase** their policy **through a broker**

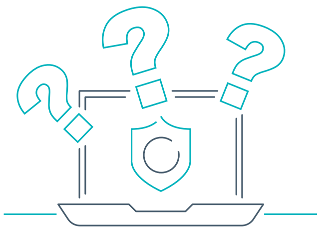


11%

of small businesses report **making an insurance claim** in the last 12 months

37%

say that they have experienced at least **one issue with professional indemnity insurance**



38%

of small businesses that have **cyber insurance do not know what their policy includes**

CONTENTS

FOREWORD

There were 5.6 million private sector businesses in the UK at the start of 2021, of which 5.5 million have between 0 and 249 employees. Small businesses, micro businesses and the self-employed play a crucial role in the UK economy and insurance is an integral part of business resilience.

An uncertain trading environment continues to threaten small firms' long-term sustainability, with the Coronavirus pandemic, the end of the transition period and the cost-of-living crisis all contributing to the financial squeeze for small businesses. In addition, the lack of availability of affordable and adequate insurance cover has been raised by small businesses as a significant barrier to their growth and innovation.

Many small businesses are reporting an increase in premiums, including on compulsory types of insurance cover, meaning that many firms have no option but to swallow the costs. Insurance is often missed from the cost of doing business debate, but it shouldn't be. Alongside increasing insurance premiums, small firms continue to deal with surging input price inflation, rising energy and fuel costs, the start of emergency post-COVID-19 debt repayments, tax increases, and labour shortages.

Small and micro businesses act more like individual consumers in the way that they buy insurance and the knowledge they have of insurance products and law. It is therefore unsurprising that many find it difficult to interpret policies as they don't have in-house insurance expertise. A lack of clear information and complex language in policies are detrimental to their ability to assess the value of the cover that they are getting for their business. It is evident that a collaborative approach is needed between the insurance industry and small business representative bodies to improve understanding through the use of plain and intelligible language, to help small firms receive quality products that are value for money.

Resilience must be built through planning for the future by learning the lessons from the COVID-19 pandemic. During the pandemic there was significant uncertainty for small firms about whether business interruption insurance would pay out, and it took the decision of the Supreme Court to determine that it should. It is critical for improvements to be made to avoid this in the future. The Government must work together with FCA as the regulator and the insurance industry itself to reduce the likelihood of businesses experiencing such uncertainty again.

For economic recovery to continue, small businesses need support to access affordable insurance. Any insurance requirements, whether in public sector contracts set out by Government or Local Authorities or as set by sector-specific regulators or professional bodies, must be proportionate. A one-size-fits-all approach risks small businesses overpaying for insurance in circumstances where many are already struggling, or policies being inappropriate with a possible impact on future claims.

The risks that small businesses face continue to change, and whether it's terrorism, cybercrime or climate change, there is more work to be done to support small business understanding and awareness of the associated risks and effective resilience measures.

We propose that governments across the UK raise awareness through key stakeholder bodies on cyber risk and signpost to relevant information, and that the insurance industry should play a role in raising awareness and helping small businesses to reach their net zero goals.

Gary Lovatt

FSB Board Director, and Policy Champion for Insurance

KEY FINDINGS

Cost of insurance

- 60 per cent of small businesses and the self-employed say that their premiums have increased in the last 12 months.
- Of those small businesses that say that their premiums have increased, over half (52%) say that their premiums have increased by 11 per cent or more in the last 12 months.
- Almost half (48%) of small businesses and the self-employed report that premium increases have had at least one impact on their business.
- Those who have reported an impact on business due to an increase in premiums say that it has led to:
  - Reduced expenditure (24%)
  - Inability to focus on business growth (12%)
  - Reduced overall insurance cover on assets and/or activities (11%).

Purchasing behaviour and understanding of insurance policies

- The most common methods used to purchase and renew insurance cover by small businesses and the self-employed include:
  - Through a broker (69%)
  - Renewed electronically/via e-mail with an existing provider (22%)
  - Over the phone (9%).
- 30 per cent of small businesses and the self-employed say that they find it difficult to understand what their insurance cover offers in terms of risks and activities.

Cost of renewing and switching insurance policies

- Over the last 12 months, 44 per cent of small businesses and the self-employed say that they have renewed with the same provider for at least one of their insurance products, and 23 per cent say that they have switched their insurance provider.
- Of those that have either renewed or switched their insurance product in the last 12 months, 16 per cent say that their cover has been restricted and 13 per cent say that their cover has been reduced.

Availability of insurance following a claim

- 11 per cent of small businesses and the self-employed report making a claim on their policy in last 12 months.

- Of those that have made a claim, a fifth (20%) of small businesses say that it was either difficult or very difficult to obtain or renew appropriate cover for their business following a claim.

Professional indemnity insurance (PII)

- Almost half (47%) of small businesses and the self-employed say that they have PII cover.
- The top reasons cited by small businesses for purchasing PII cover include:
  - To protect themselves and their business against future claims (62%)
  - Required by their client as a condition of doing business (39%)
  - Required by their regulator or professional body (30%).
- 62 per cent of small businesses say that their PII premium has increased in the last year.
- Over a third (37 per cent) say that they have experienced at least one issue with PII cover, including:
  - Overly expensive premiums (27%)
  - Difficulty securing adequate cover (15%)
  - Reduced/restricted cover for activities (15%).

Cyber insurance

- 10 per cent of small businesses and the self-employed say they have cyber insurance.
- Of those small businesses that do have cyber insurance, 38 per cent do not know what their policy includes.

RECOMMENDATIONS

Securing adequate cover

UK Government should work together with the insurance industry to agree the conditions under which a Government announcement or action would trigger a joint response, with clear conditions and expectations agreed taking into account any impact on small businesses. Building on the work of Pandemic Re, planning ahead on any measures and conditions under which an intervention would take place would help to mitigate the risk of uncertainty for businesses and facilitate a unified and swift response. A response for an unprecedented event should continue to be explored and must be supported by the development of a clear framework for a public-private partnership, identifying exactly how such a scheme would be triggered, for example, where market-wide restrictions or reductions of cover threaten business sustainability.

The Financial Conduct Authority (FCA) should be explicitly required to consider intervening in a market if it becomes clear that there is a segment/sector of businesses that are unable to obtain insurance. Establishing a mechanism to consider intervening in a market would help to identify and act on issues as early as possible, as well as helping to reduce the impact on businesses if there is a lack of suitable cover available in the market. If the decision is made not to intervene, then for the purpose of transparency and accountability a statement should be provided outlining the reasons why.

Understanding of insurance policies

The insurance industry should work together with small businesses through relevant representative bodies to help to improve the understanding of insurance products. This could encompass improving the clarity of policy wording and including a clear breakdown in the policy of the assets/risks covered, to help display information in a comprehensible manner. A significant proportion of small businesses find it difficult to understand what their policy offers in relation to their business risks/activities, regardless of whether they have used a broker to purchase or renew their insurance. FCA rules already state that a customer must be given appropriate information in a comprehensible form about their insurance policy, so they are able to make an informed decision. A collaborative approach between the insurance industry and other representative bodies would help to facilitate a better understanding of small businesses and offer solutions, for example through guidance or codes of practice for the insurance industry on small businesses' needs.

Business interruption insurance

UK Government should work together with insurers and the FCA as the regulator to agree specific conditions for forms of Government support that should not be taken into account when calculating business interruption insurance (BII) claims. During the pandemic, a number of insurers had deducted Government-backed loans and grants from BII pay-outs, leading to a period of uncertainty for small businesses. While there is understanding across the insurance industry on the forms of support that should not be taken into account normally, during unprecedented events and particularly in situations where grants could not have been anticipated there should be clear guidance issued to avoid inconsistency. This could be mitigated in the future by agreeing to conditions under which support should not be taken into account by insurers when calculating claims.

Professional indemnity insurance

The FCA should launch a market study into PII and consult on the proposed remedies. This could help identify problems and remedies in relevant sectors. The market study could explore the reasons for market hardening, whether these reasons impact some businesses more than others, and examine the value of offering PII on a losses occurring rather than claims made basis. Our research shows that those small businesses that buy PII because it is a requirement are almost twice as likely to report overly expensive premiums than those that buy it for other reasons. This highlights the need for an assessment of the market in more detail, including whether there is a disproportionate size penalty when it hardens.

The FCA should extend its general insurance value measures reporting requirements to PII, and consider extending them to a wider selection of commercial insurance products bought by small businesses. In addition to this, reporting requirements should be expanded to include information about the nature of the claims, so that insurers, brokers and their customers can better assess the state of the market. Current reporting requirements apply to the consumer home and motor insurance markets, and some associated products. We believe that there would be value in extending reporting requirements to commercial products as well as providing more detailed information on claims. While this will not resolve hard market issues on a broader scale, this measure might help prevent blanket exclusions and prevent insurers pulling out of whole markets.

UK Government should convene discussion with relevant sector-specific regulators and professional associations, to ensure that PII requirements that are imposed as a condition of being able to practise are assessed so they do not disadvantage small businesses. Mandatory minimum levels of PII cover can act as a barrier to entry for small firms, and PII premiums will often make up a bigger proportion of their turnover than for larger firms. Minimum requirements set by sectoral regulators should be stress-tested on a regular basis to assess their impact on small businesses and their ability to compete.

UK Government should use the Procurement Bill to remove barriers for SMEs in accessing public procurement opportunities. This should include commitments not to impose unlimited liability for public contracts, to share risk reasonably, and to ensure that both PII and public liability insurance requirements in public contracts are proportionate to the size of the contract. With the majority of small businesses bidding for lower value contracts, proportionality to the size of the award is key. Small businesses should not be discouraged or disadvantaged by requirements set out in public sector contracts.

UK Government should take a shared risk approach with suppliers in relation to public contracts, and ensure that requirements are not simply passed down the supply chain. This would also help smaller firms innovate in the public sector, by giving them more freedom and lower levels of risk to find new solutions to old problems. Currently, small businesses are sometimes prevented from taking on additional commercial activity indirectly where requirements are passed down regardless of the fraction of the work being undertaken by the small business in question.

Terrorism insurance

UK Government should assess whether to extend the Pool Re cover to include intangible assets in the event of a terrorist cyber-attack. With the increasing number of small businesses increasing their online presence during the pandemic, an extension to the Pool Re cyber trigger to cover intangible as well as tangible assets in the event of a terror-driven cyber-attack should be considered. It could help to protect small businesses, bring the scheme in line with the cyber risks that businesses face, and improve business engagement and awareness. This may require collaboration with insurers which provide existing cyber policies to understand better how such a risk could be incorporated into policies.

Trade credit insurance

The insurance industry should continue to develop flexible trade credit insurance options for small businesses, and work together with a range of stakeholders including FSB to help raise awareness of and access to such options. Only 2% of small businesses report buying trade credit insurance. While there are some options in the market for small businesses to cover lower invoice amounts, for example pay-per-invoice policies, more focus on simplifying and developing more flexible options as well as raising awareness would improve access to trade credit insurance for small businesses.

Cyber insurance

Governments across the UK should raise awareness of the cybercrime risks to small businesses through campaigns similar to Cyber Aware, and help signpost to relevant information through support services like Business Wales. The 2022 National Cyber Security Strategy sets out the government's plan to mitigate the risk of cyber-attacks on individuals and businesses. For small businesses, the strategy recognises the need for tailored and targeted guidance and tools to be made available in order to improve understanding and awareness of cyber security. While the tools and guidance are available, our data shows that very few small businesses access this information. Some of the reasons cited for this are lack of awareness of the available information and understanding of cyber risk.

Net zero

The insurance industry should have a role in raising awareness and incentivising businesses to make sustainable choices.
For example, lower premiums or excesses could be deployed to encourage businesses to act on climate change, and information could be provided to small businesses on the steps they can take to reduce their climate risk. This would be in line with the model used for cyber insurance where insurers reduce premiums for good cyber hygiene. This would help to reduce the cost for small businesses in transitioning to net zero, thereby tackling some of the financial barriers that small businesses experience in relation to making more sustainable choices and aiding their future resilience.

INTRODUCTION

Commercial insurance has the potential to be a great tool in not only protecting small businesses from risks and uncertainties, but also in facilitating growth through increasing consumer confidence and allowing for innovation. It is an integral part of business resilience planning.

However, almost all areas of insurance have been affected by the COVID-19 pandemic. Small businesses were hit hard by the pandemic and have spent the last two years fighting to stay afloat. Many small firms lost their income or experienced a decline in their revenues as a result of various national lockdowns and other trading restrictions.

The trading environment for small businesses has been especially challenging during the pandemic, with 56 per cent reporting an annual drop of sales in 2020, 47 per cent reducing their operations, and 31 per cent closing completely during restrictions.[1] Obtaining and claiming on insurance policies has also proved to be challenging. A number of claims in relation to business interruption insurance were found not to cover businesses' losses during the pandemic. The hardening of the professional indemnity insurance market has led to a lack of appropriate and affordable insurance for small businesses in some key sectors such as construction and advisory services, while premium increases have had an impact on the ability of small businesses to conduct operations.

Combined with decreased income and increased costs, this has exacerbated the risk of underinsurance for small businesses – including not being able to claim, a lack of understanding of policies, as well as an increase in reductions and/or restrictions in insurance cover.

Looking forward, it is crucial that small businesses continue to recover from the pandemic's effects on their business, and continue to build their resilience. This research identifies some of the key challenges, the growing costs associated with insurance, and the difficulties that small businesses experience in engaging with the insurance industry.

The aim of this report is to highlight challenges and barriers to small businesses in obtaining appropriate and affordable insurance, and to understand small business behaviours as consumers of insurance, along with the impact of the COVID-19 pandemic on their perceptions of insurance.

The findings of this research have informed the policy recommendations to support small businesses in obtaining insurance, which will help to alleviate some of the challenges that they have experienced.

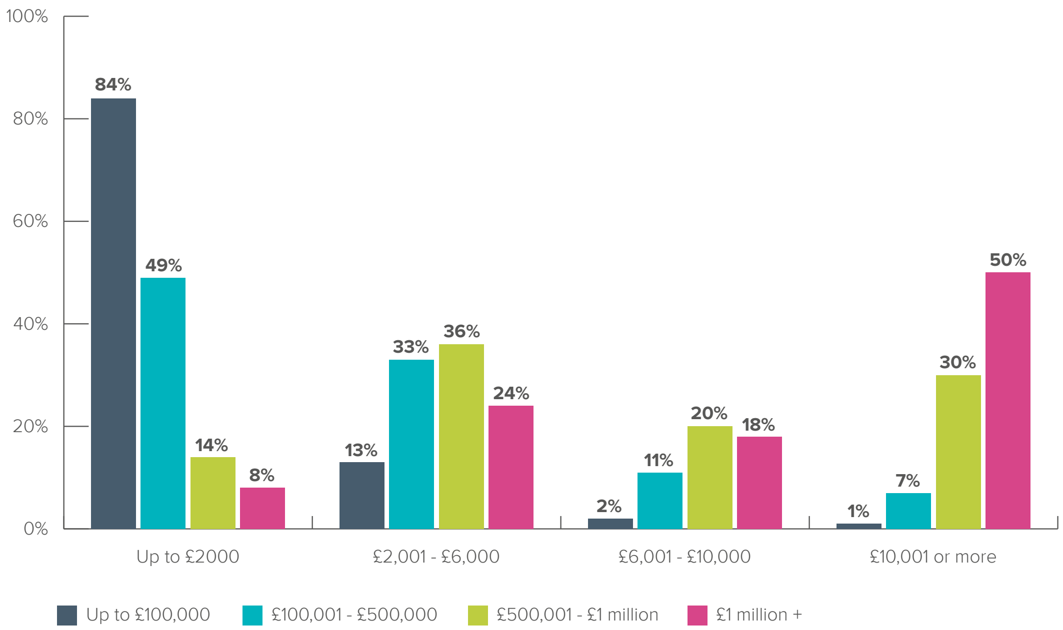
1 Department for Business, Energy & Industrial Strategy (BEIS), Longitudinal Small Business Survey: SME Employers (businesses with 1-249 employees), August 2021, p2 [PDF]

THE RISING COST OF INSURANCE

FSB has long highlighted the rising cost of doing business. In FSB's Small Business Index, for Quarter 1 2022, a record-high number of small businesses (87%) reported a rise in their costs, with 33 per cent of small businesses saying they had seen a significant increase.[2] There are a range of drivers for this, including fuel, utilities, staff costs and taxation. The cost of insurance can often be missed from this discussion, but it is another factor that has driven up small business costs over the past year. Figure 1 shows the total combined annual cost for small business commercial insurance policies in comparison to their turnover.

Figure 1: Total combined annual cost of insurance compared to the annual turnover for small businesses

Source: FSB Insurance and Finance survey 2022



Half (50%) of small businesses say that their annual combined cost of insurance is less than £2,000, which is perhaps not surprising given that, of that proportion, 84 per cent have an annual turnover of £100,000 or less. As the annual turnover of the business increases so does the cost of insurance - 50 per cent of small businesses with an annual turnover of £1 million or more report that their annual cost of insurance is £10,001 or more.

Looking at the cost of insurance premiums, the majority of small businesses (60%) say that their commercial premiums have increased over the last 12 months, in comparison to 28 per cent that say their premiums have stayed the same, and 3 per cent that say that they have decreased. There are also some sectoral differences with regard to reported premium increases. Small

2 FSB, Voice of Small Business Index, Quarter 1, 2022, May 2022

businesses in manufacturing (62%) and wholesale and retail (61%) sectors are more likely to state that their commercial insurance premiums have increased in the last 12 months in comparison to small firms in professional, scientific and technical activities (53%) and information and communication (49%) sectors.

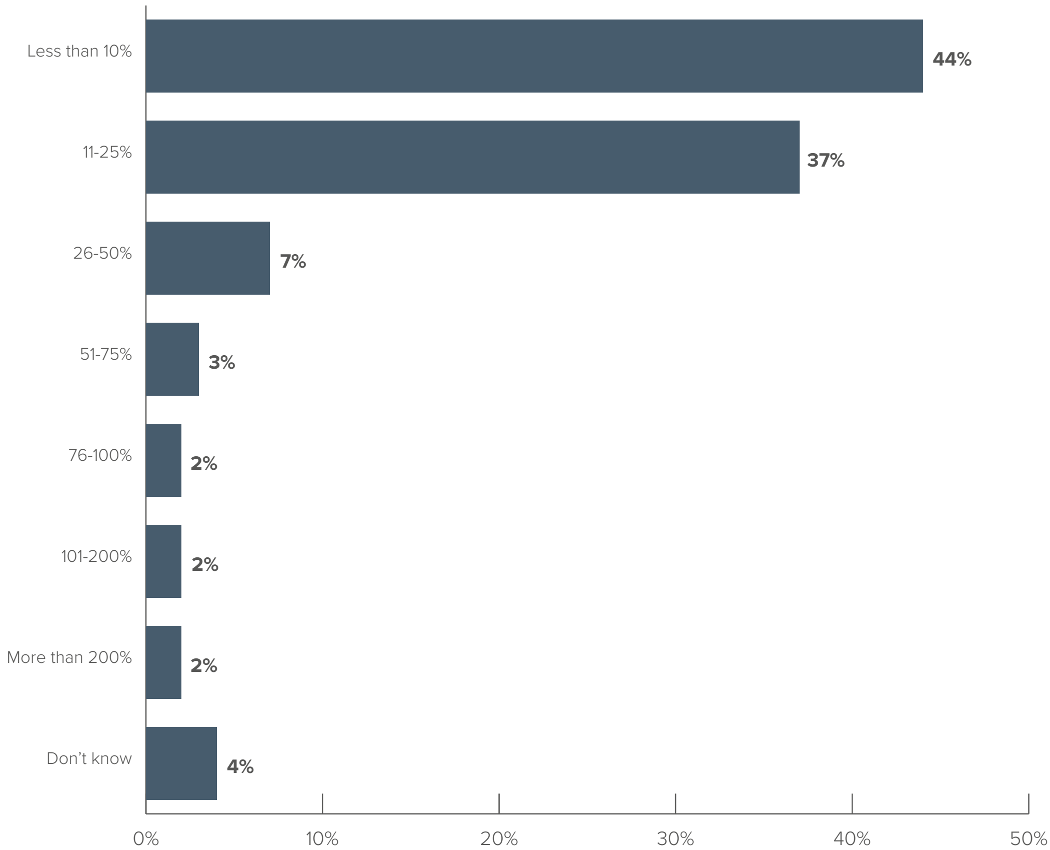
It is evident that small businesses in some regions have been more affected by increases in premiums than others, with the highest proportion of reported premium increases in East Anglia (66%) and the East Midlands (65%), and the lowest in the North East, Yorkshire, and the Humber (58%) and the South East (58%).

There are a variety of reasons as to why commercial premiums may have increased for small firms, including claims history, changes in circumstances of the business such as business expansion, or new business activity in a new overseas market. Looking across the small business population as a whole, the hardening of the insurance market following the Grenfell disaster and the pandemic have also contributed to an increase in commercial insurance premiums.

44 per cent of small firms who report a premium increase say that their overall insurance premiums have increased by 10 per cent or less in the last 12 months, closely followed by 37 per cent who that say their premiums have increased by between 11 per cent and 25 per cent. Premium increases can put a significant financial strain on a small business, so it is concerning to see 16 per cent of small businesses say their premiums have increased by more than 25 per cent in the last 12 months.

Figure 2: Estimated increase to insurance premiums for small businesses in the last 12 months

Source: FSB Insurance and Finance survey 2022



Small businesses have been disproportionately affected during the pandemic, as they are less likely to have financial reserves in comparison to larger businesses and therefore less likely to be able to absorb increased costs.

Increases in insurance premiums have placed a considerable strain on small businesses, particularly for those in the accommodation and food services sector that have been hit hard by the pandemic and by significant increases to food and energy prices.

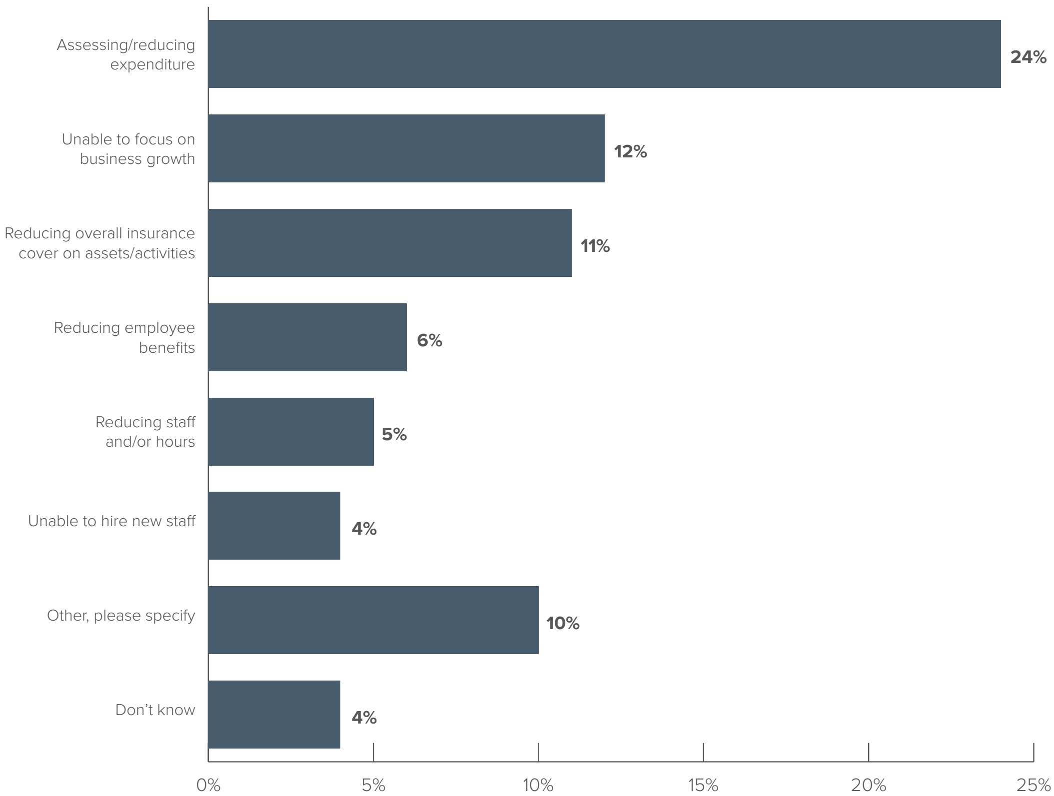
> **"An increase in premiums adds to other rising costs such as fuel and food prices, particularly if you're a very small business. All these costs are adding up and it makes you think, is it [the business] worth continuing with. We've definitely seen, I would say, a disproportionate number of smaller businesses that are changing hands and sometimes not staying in the hospitality sector."**
>
> FSB member, Hospitality, North West

Our research found that almost half (48%) of small businesses state that premium increases have had some sort of an impact on their business. Of the impacts reported, almost a quarter (24%) say that it has led them to assess and/or reduce their expenditure, to an inability to focus on business growth (12%) and to a reduction in their overall insurance cover on assets and/or outgoings (11%).

> **"...as far as food costs and overhead costs are going, I think we've increased our menu prices, probably three times in the last six months. Unfortunately, we have no alternative but to pass it on to the consumer."**
>
> FSB member, Hospitality, Northern Ireland

Figure 3: Impact of insurance premium increases on small firms

Source: FSB Insurance and Finance survey 2022



Our research found that small firms have also experienced challenges in obtaining insurance following the end of the Brexit transition period. Small businesses have reported having no choice but to take on the risk when trading overseas.

> “I export a lot and one aspect of insurance that has become impossible is getting transport insurance for shipping goods, particularly in the EU. I can easily insure goods going to the USA or Japan, but at the moment, getting insurance that covers transit to the EU has proved impossible. I didn’t have any issues at all with transit insurance pre-Brexit. Transition times were very short, I could get products from my factory in Bolton into nearly every part of Europe within 48 hours and border crossings were quick. What I have found post Brexit is that a lot of items go missing, because shippers or the transport companies are far more likely to consolidate shipments and so things can sit around in the warehouse for a week or two until they get a truck going to the right place. I would say that apart from delays, probably, one consignment in ten has got lost for at least a week and in one case for six months.”
>
> FSB member, Manufacturing, North West

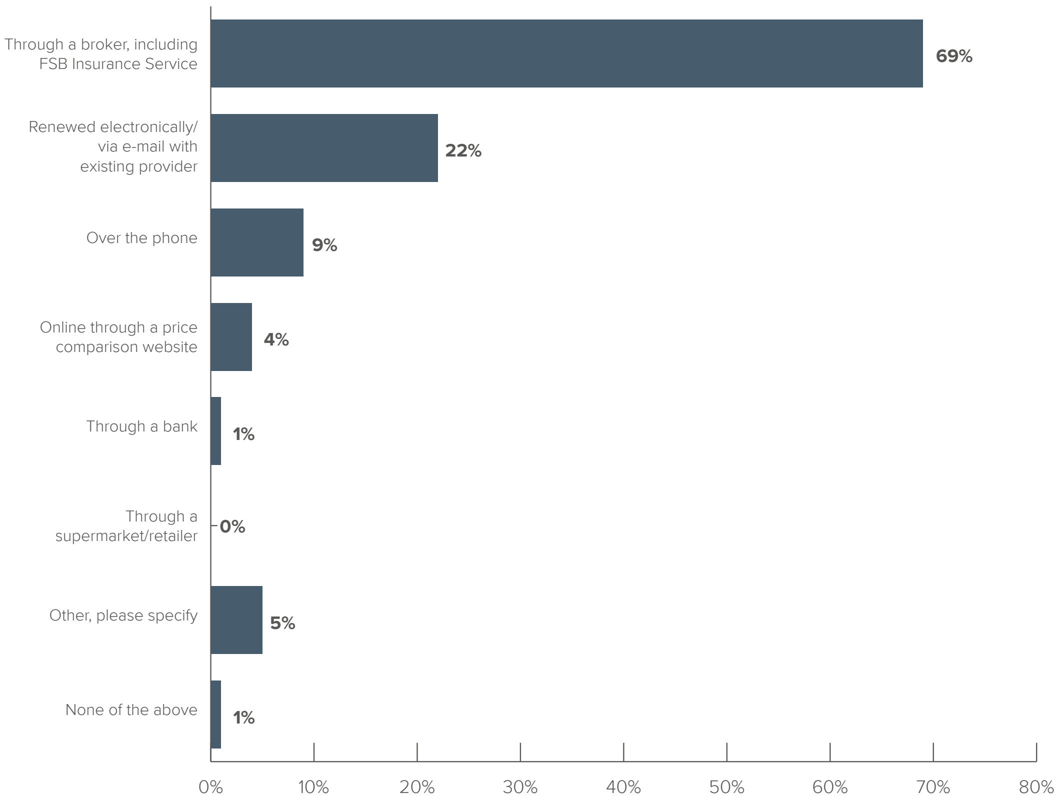
SECURING ADEQUATE COVER

Underinsurance is a significant problem for small businesses. It includes limits of indemnity being too low, or property or assets being valued at less than their actual worth, resulting in inadequate insurance cover and consequently affecting the amount paid out. Small businesses are particularly at risk when underinsured, due to not being able to absorb any unforeseen shocks or expenses at the same rate as their larger counterparts. The rising cost of materials and unpredictability within supply chains have heightened the risk of underinsurance.

Brokers can help mitigate the risk of underinsurance. The majority of small businesses (69%) say they have either purchased or renewed their insurance policy through a broker, including FSB Insurance Service, followed by electronically/via e-mail with an existing provider (22%).

Figure 4: Method small businesses used to renew and/or purchase commercial insurance

Source: FSB Insurance and Finance Survey 2022



A significant proportion of small businesses experience difficulties in understanding their policies in relation to business risks and activities. Three in 10 small businesses (30%) find it difficult to understand what their policy offers for each of their business's risks and/or activities, with small firms in retail (44%) and manufacturing (36%) more likely to report difficulties. Conversely, 51 per cent of firms say they find it is easy to understand their policies, with small businesses in professional, scientific and technical activities (58%) and information and communication (54%) sectors more likely to report it being easy.

Insurance is a technical and complex area, which the most learned consumer can struggle to navigate. Moreover, terms found in policies may not be comprehensible if hidden in tiny print. Brokers have a key role in providing clarity and understanding between the insured and insurers in order to put into place appropriate insurance cover.

Seeking advice and in particular purchasing insurance through a broker is often recommended, in order to mitigate the risk of complexity leading to purchasing an unsuitable insurance product. However, our research shows that small businesses that have used a broker to renew or purchase their insurance in the last 12 months are more likely (33%) than those who have obtained insurance by other means (28%) to find it difficult to understand their policy.

This may be because the typical business that uses a broker might be choosing to do so because their insurance needs are inherently more complex than a typical business that chooses not to use a broker. By using a broker, they are therefore mitigating the risk that a lack of understanding may lead to an unsuitable purchasing decision.

The use of complex language within insurance policies has also been cited by small businesses as one of the barriers to being able to assess their policy against business risks and activities.

> **"Everything is in what I call 'legalese', it's not easy to determine exactly what they're [insurance providers] talking about and what you are and aren't covered for. How do they expect anybody to be able to read through all of these documents and understand everything that's in it? I think it should be a lot clearer so anyone that reads it understands it"**
>
> FSB member, Manufacturing, East Midlands

FCA rules in the Insurance Conduct of Business Sourcebook (ICOBS)[3] already state that a customer must be given appropriate information about their insurance policy in a comprehensible form, so they are able to make an informed decision. However, there is still an information asymmetry between small businesses and insurers, leaving them vulnerable to underinsurance. This highlights the need for further collaboration between the insurance industry and other representative bodies to help better understand small businesses' needs and to communicate information in a more readily comprehensible manner.

Regularly reviewing insurance policies can also benefit small businesses and help tackle issues surrounding underinsurance, particularly if the

3 FCA, Insurance Conduct of Business Sourcebook, May 2022

business or the trading environment changes. For others, sharing best practice, information and knowledge through informal groups and networks proved beneficial during the pandemic.

> **"I do review the policy cover quite religiously, not least because I'm always looking potentially to reduce the premium, where I can. And at the same time, I'm not wishing to be caught out by being underinsured."**
>
> FSB member, Wholesale and retail, West Midlands

> **"In terms of my peers, we talk to each other all the time and through Covid, especially during the lockdown. We shared information, this included talking about good and bad experiences, in particular insurance. Businesses were shopping around and sharing information at a level that I've never seen before. Those providers that have upped their game will benefit from it."**
>
> FSB member, Hospitality, North West

44 per cent of small businesses report that they have renewed with the same provider for at least one of their insurance products in the last 12 months, and 23 per cent say that they have switched insurance provider.

Restriction (e.g. a higher excess or a lower indemnity limit) or reduction (e.g. cover for floods or other types of event being withdrawn) of cover is also a factor in underinsurance. Of those small businesses that say that they have either switched or renewed their policy in the last 12 months, 16 per cent say that their cover has been restricted and 13 per cent say that their cover has been reduced.

There are also wider implications of a small business not being able to secure adequate cover. Small businesses that often provide specialised products and services report issues with securing appropriate employers' liability insurance, and the impact that it has had on their ability to hire apprentices.

> **"The issue we've had is with getting insurance, we've been looking to take on an apprentice and cannot get employers' liability insurance due to the kind of equipment we are using. The racing cars we build are historic cars that were designed in the 50s, 60s, and 70s, so we do use some quite old-fashioned equipment, and getting employers' liability insurance for things like fly presses and at the other end of the spectrum laser cutting equipment is challenging and just about every insurance company has said no. One insurance company said yeah that's okay, and our premium was going to go from £350 a year to £6,000. This is why we have not been able to take on apprentices, which is a bit sad."**
>
> FSB member, Manufacturing, North West

Other sectors that have also been disproportionately affected by pandemic restrictions, such as the live events and recreation industries, have found it increasingly difficult to secure insurance for their business. In this case, the Government has aimed to support the live events industry with the Live Event Reinsurance Scheme, which launched on 22 September 2021 and will close on 30 September 2022.[4] Given the vast number of cancellations and postponements of events during the pandemic, it is unsurprising that insurers considered the sector as high-risk.

Reinsurance schemes protect policy holders, and with the Government acting as the reinsurer this allows insurers to continue to offer the protection that businesses need. However, some small businesses have reported issues with the scheme, such as it being overly expensive, and postponements and event cancellations are only covered in the event of UK Civil Authority restrictions, while COVID-19 sickness absences or the costs of social distancing measures are not covered.

CASE STUDY

"The events insurance has not been helpful, and the Government-backed Live Event Reinsurance Scheme costs a lot more and is only triggered by a Government announcement of a lockdown. However, it does not include other issues that may prevent the event going ahead, such as staff absence due to COVID-19. It is also more costly: we used to pay £600 for event insurance, now the cost is 5% of total value of insured costs plus premiums. This would mean that the exhibition event for example, which accounts for less than half of the total series of events that we plan, would cost around £3,500 – a significant increase on the £600 that we paid previously for the total cost of insurance.

Given the situation this would only be acceptable if the cover applied to other potential COVID-19-related scenarios that lead to event cancellation and not just be triggered by a lockdown. There is also a very limited list of insurance providers to choose from and the scheme only covers the costs of an event cancellation but not lost revenue. So, at the point where the insurance kicks in there is no cash left to refund ticketholders and the associated administrative costs such as card fees are also not included. This adds to the additional losses for event organisers."

FSB member, Events industry, London

Leisure and hospitality venues have been particularly disadvantaged during the pandemic, not least due to long periods of closures and further

4 Gov.uk, Live Events Reinsurance Scheme, September 2021

restrictions such as social distancing measures. Insurers have also become more risk-averse, with some even withdrawing from whole sectors.

A historic LGBT+ sauna faced permanent closure after operating for more than 20 years, after finding out that insurers had withdrawn from the sector. The business struggled to gain access to insurance after it lost buildings and employers' liability insurance. In 2021 FSB called on the insurance industry to step up and for the Government to intervene if necessary to protect LGBT+ community interests and help businesses gain access to insurance cover. While the sauna was eventually successful in securing insurance for its business, the uncertainty and lack of support from insurers at a critical time contributed to a lack of confidence in insurance providers.

CASE STUDY

"We had a combined business and property insurance, and we struggled to get cover for the property for seven months. The two insurers that we found kept playing one type of cover against the other, and we were quoted £25,000 in total for the year – an over seven-fold premium increase on the year before. We had no previous issues with getting insurance in over 20 years that we have been operating.

After months of searching and the market opening up a bit, the owner of another sauna suggested a broker to use, and I managed to secure cover, although we still had to accept a 25% premium increase on the previous year. But without that I am not sure what would have happened.

The ombudsman ruled in our favour two months ago on the business interruption case but there has been nothing but delays so far. The Supreme Court ruled that interim payments must be issued following such a ruling, but the insurer still believes that there is no claim. The whole process over the last two years has been long and frustrating."

Nick Batt, Pink Broadway, South East

Recommendations

- **UK Government should work together with the insurance industry to agree the conditions under which a Government announcement or action would trigger a joint response, with clear conditions and expectations agreed taking into account any impact on small businesses.** Building on the work of Pandemic Re, planning ahead on any measures and conditions under which an intervention would take place would help to mitigate the risk of uncertainty for businesses and facilitate a unified and swift response. This should include exploring the conditions for a Government-backed insurance scheme whereby if a business fails to secure necessary insurance due to restrictions, meaning the business is unable to operate due to a lack of insurance in the market, then there is a case for the Government to intervene and provide a baseline of cover. A clear framework outlining a case for when an intervention should occur should be developed. There is currently legislation which allows claiming for personal or business property in the event of a riot, and if the property was not insured or not adequately insured and the claim was rejected by the insurer then a claimant can apply to a claims authority to recover costs.[5] While we recognise similar legislation would not be suitable in this case as there would be difficulties around defining a future unprecedented event, we believe that this is a good example of the way in which a framework, with criteria and conditions specified in advance, could be developed for an intervention, including a public-private partnership in sharing risk. The scheme could be triggered where market-wide restrictions or reductions of cover threaten business sustainability.
- **The Financial Conduct Authority (FCA) should be explicitly required to consider intervening in a market if it becomes clear that there is a segment/sector of businesses that are unable to obtain insurance.** Establishing a mechanism to consider intervening in a market would help to identify and act on issues as early as possible, as well as helping to reduce the impact on businesses if there is a lack of suitable cover available in the market. If the decision is made not to intervene, then for the purpose of transparency and accountability a statement should be provided outlining the reasons why.
- **The insurance industry should work together with small businesses through relevant representative bodies to help to improve the understanding of insurance products. This could encompass improving the clarity of policy wording and including a clear breakdown in the policy of the assets/risks covered, to help display information in a comprehensible manner.** A significant proportion of small businesses find it difficult to understand what their policy offers

5 Gov.uk, Riot compensation: quick guide for claimants, 25 March 2019

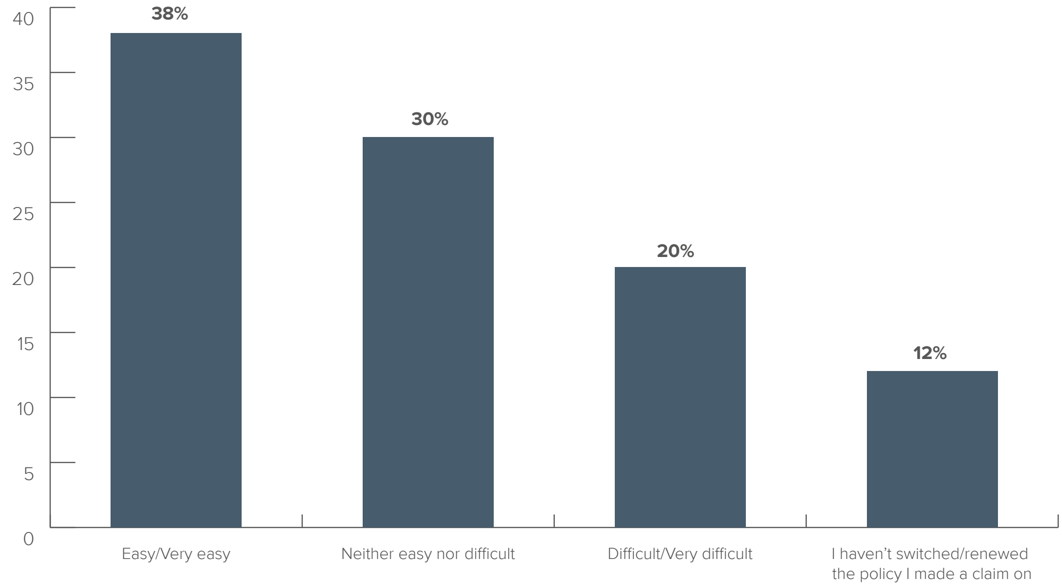
in relation to their business risks/activities, regardless of whether they have used a broker to purchase or renew their insurance. FCA rules already state that a customer must be given appropriate information in a comprehensible form about their insurance policy, so they are able to make an informed decision. A collaborative approach between the insurance industry and other representative bodies would help to facilitate better understanding of small businesses and offer solutions, for example through guidance or codes of practice for the insurance industry on small businesses' needs.

MAKING CLAIMS

FSB research shows that 11 per cent of small businesses have made an insurance claim in the last 12 months. Of those that have made a claim, a fifth (20%) say it was either very difficult or difficult to obtain or renew appropriate cover for their business following a claim, and 38 per cent say that it was either easy or very easy to do so.

Figure 5: Small business views on the ease of obtaining and/or renewing appropriate cover for their business following a claim

Source: FSB Insurance and Finance survey 2022



The experience of small businesses making claims during the pandemic, particularly in relation to business interruption insurance, has fuelled anxieties and a lack of confidence among businesses about the insurance sector.

> **"Literally just before the pandemic hit, I took out business interruption cover. We did everything we could during that time to ensure that the clients were looked after. We produce record books for NHS ambulances, and wanted to keep everything running here as best we could to support our community and clients. When we put in a claim for insurance, they said we had no claim, because we didn't close completely. To me, that was so frustrating. We were doing the best we could in adverse conditions, and we were keeping a trickle of business going through which is better than closing altogether, thinking that it would minimise whatever the claim might be as you could offset some of the losses with some business coming through, but the insurers wouldn't have any of that.**
>
> **We've done everything we can to sustain the business and keep it going and look after our clients to make sure that we've still got a**

business moving forward, and we've been penalised for it. I'm not happy with it. I think business interruption insurance is very expensive and you don't actually get any real cover."

FSB member, Manufacturing, East Midlands

TYPES OF INSURANCE

The type of cover a business may wish to take will depend on a range of factors, such as business size, if the business employs staff, and whether it trades online or overseas. There are some types of insurance that are legally required for businesses, for example employers' liability insurance or commercial motor insurance if the business uses vehicles.

The sector the business operates in may also affect the type of insurance the business may wish to take; for example, small firms in the construction sector may use contractors' all risks insurance. Small firms may also take out professional indemnity insurance which indemnifies professionals against claims that arise out of the course of their ordinary business activities.

Business interruption insurance

Business interruption insurance (BII) compensates policyholders for costs arising from events that close or severely disrupt operations, primarily as a result to damage to premises and/or equipment. Over a third of small businesses (35%) say they have business interruption insurance. One key issue for small businesses has been the lack of coverage in light of the pandemic as part of BII, leading to many claims, as well as disputes about whether and how far policies did (or should) provide cover for losses.

During the pandemic, numerous FSB members highlighted problems with BII. Small businesses feel that insurance providers should have been acting in good faith to support them through the crisis. In January 2021, the UK Supreme Court handed down judgment in *Financial Conduct Authority v Arch & Others*,[6] the test case regarding insurance coverage for business interruption losses arising out of the pandemic. FSB worked together with the Financial Conduct Authority (FCA) on behalf of small businesses on the outcome of the test case. The court was asked to determine whether three kinds of non-damage business interruption extension clauses (i.e. disease clauses, prevention of access clauses, and hybrid clauses) would respond to the interruptions caused by the COVID-19 pandemic, and ruled in favour of the policyholders. The test case is significant for several reasons, most importantly because it allowed small businesses to claim on their policies where possible for business interruptions caused by the pandemic.

Reviewing and assessing BII policies in the context of COVID-19 restrictions and claims outcomes would have prompted insurers to provide greater support to businesses impacted by the shutdown prior to the test case being brought, including supply chain businesses, meaning many would not have needed other forms of support.

The FCA was right to argue that disease or denial of access clauses within interruption policies should trigger pay-outs in the event of COVID-19-linked disruption. FSB urged insurers to pay out swiftly following the Supreme

6 The Supreme Court, *Judgment: FCA v Arch & Others*, January 2021

Court judgment, and highlighted that businesses had already experienced countless delays, not least due to waiting for the outcome of the case. However, over a year after the Supreme Court's judgment, a number of small businesses were still struggling to access support during the claims process. Many small businesses lost confidence in their insurers because of difficulties in making claims and obtaining pay-outs.

> **"During the height of the pandemic there was no communication from the insurers. Having experienced the impact of COVID-19 on the business I know first-hand the importance of business interruption insurance. It's essential. I'm more aware of the need to make sure what I'm purchasing is going to cover my business. What I've encountered to date is a joke – I feel I've been defrauded.**
>
> FSB member, Manufacturing, East Midlands

Some small businesses also reported issues with insurers taking into consideration Government COVID-19 support packages when considering pay-outs on claims. This is particularly concerning as Government financial support schemes were funded by the taxpayer to help businesses stay afloat, not to subsidise the insurance industry.[7]

> **"We've had a bit of a bad experience with business interruption, as you can imagine. We had business interruption insurance and the insurers were initially going to pay out, but then they said that the grants we got from the Government covered what they would have paid. Which smacked us in the face a little bit because I thought well, you know, if we're paying you for your business interruption insurance you should be paying us so that we can then maybe pay back the Government what they're given to us, [that is] the taxpayer. I thought it was typical of larger organisations making sure their profits aren't hit by what they should be insuring you for."**
>
> FSB member, Wholesale and retail, East Midlands

In September 2020, the Association of British Insurers (ABI) confirmed that following agreement with 12 insurance firms they "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."[8] However, the Government's response has been that their expectation is that other firms would follow suit and take these matters into account.

7 Browning, S, Coronavirus: Business interruption - House of Commons Library, November 2021, p25 [PDF]
8 Association of British Insurers, Letter to Economic Secretary, September 2020 [PDF]

Income protection insurance

One of the biggest challenges facing the self-employed is not being able to rely on a secure income, and this has been exacerbated over the past two years. They are not entitled to statutory sick pay, and also run the risk of not being able to generate a steady income in the event that they have to assume caring responsibilities.

Income protection insurance can be one of the tools that the self-employed could draw on to manage financial risks. One in ten small business owners (11%) say they have income protection insurance, which covers an individual in the event of not being able to work due to illness. Income protection insurance can come with strict eligibility criteria and obligations, depending on such factors as the type of job, age of the policyholder, and percentage of income that needs to be covered. The conditions are particularly difficult for groups that may carry higher risks; for example, there may be exclusions for those with pre-existing medical conditions. This can act as a barrier for the self-employed when trying to arrange this type of cover.

Flood insurance

The impact of flooding and flood water on businesses can be significant and wide-ranging. A 2021 report by Aviva found that almost one in three commercial properties are at risk of flooding.[9] Flood insurance plays a crucial role in the management of financial losses associated with flood damage.

The direct damage caused by flooding of business premises can have a devastating and long-term impact on business operations, with far-reaching consequences for profitability. It is worth noting that major flood events can also lead to devastating indirect consequences for business operations, particularly when flooding and damage to infrastructure disrupts staff availability, supplies and deliveries, utilities, and customer footfall.

9 Aviva, Aviva’s flood report, April 2021

CASE STUDY

"During the pandemic the surrounding drains could not cope with the flash flooding, which resulted in the sewage water escaping through the pipework into our basement which acts as our stock room. We were advised to get a clean-up organised to remove the sewage damaged items and begin the drying process.

For weeks we had five industrial sized driers not in use (hired out but not being used) while we waited for authorisation from the insurers to approve the strip-out so the drying could be completed, and cleaning could commence. As we had to move all the stock from the basement to the shop floor when it flooded, we were not able to open the store, and missed out on our busiest [trading] period because of the unnecessary delays.

When we tried to claim on the insurance, they said we had no claim as the water flood level was recorded as 4 inches, and our insurer said that our policy required us to store stock above 7 inches, but no one actually came to measure the flood level damage. We couldn't open for a further 6 weeks as we were unable to get insurance due to an unsettled claim, but at the same time no one would come to look at it. When we did manage to secure insurance, the cost had quadrupled and the excess was £7,000, and we had no choice but to settle on this as we needed to open. It has been a nightmare."

Kathleen Morrison, Wool for Ewe, Scotland

Insurers take into consideration any action that a business has taken to mitigate the risk of flooding and generate a price through flood mapping technology. However, businesses that have previously suffered from flooding a number of times can find it particularly difficult to obtain flood cover, with exclusions, higher premiums or excesses applied.

The Flood Reinsurance Scheme (Flood Re)[10] provides insurers with the opportunity to purchase subsidised reinsurance against flood risk where they are not prepared to underwrite flood risk themselves. Flood Re only covers certain domestic properties which are able to meet set criteria. It does not include small businesses.

Because Flood Re does not include commercial premises, an alternative solution for small businesses is required. The British Insurance Brokers' Association's recent extension to the flood insurance scheme was designed to help bridge some of the gap by offering a limit of £25,000 or £50,000 for businesses with under £1m of assets.[11]

10 Flood Re
11 British Insurance Brokers' Association, New SME flood insurance product for BIBA members, March 2022

Terrorism insurance

The least common forms of insurance small businesses say they have are terrorism (4%) and trade credit insurance (2%).

One of the most common misconceptions for terrorism insurance is that it is relatively low risk for small businesses, particularly for those in rural areas. Another is that it only applies to material damage caused to property. Small businesses are less likely than larger businesses to be able to deal with the aftermath of a terrorist attack, not only in terms of any material damage to property but also in terms of lack of reserves to withstand any significant long-term disruption. Therefore, preparation and resilience planning are key.

Progress has been made since the publication of FSB's 2017 report on terrorism, *Small business as usual*, which identified the importance of the availability of information about terrorist threats for small businesses.[12] Since then, Pool Re has announced the investment in and launch of an information-sharing platform in collaboration with UK National Counter-Terrorism Police, to address risk awareness and mitigation, access insights on mitigation, and receive updates and training.[13] This will help to close some of the information gap for small businesses in relation to terrorism and its impacts on operations, and enable them to better plan in the event on a terrorist attack.

Terrorism insurance is covered by the Government-backed Pool Re scheme. The recent HM Treasury review of the Pool Re scheme recognised the challenges for small businesses in obtaining terrorism cover.[14] The review proposed reducing overall scheme pricing by 20 per cent with specific reductions in areas with less coverage to make this type of insurance more affordable and suggested that the Government and Pool Re work together to address the lack of awareness amongst small businesses of the value and benefit of terrorism cover.

The growth in sophistication of terrorist attacks and the digital tools available to terrorists means that an attack could also be conducted through cyber means, which Pool Re acknowledged in 2018 by adding cover for the physical and direct business interruption impacts of cyber terrorism. However, the cover currently excludes intangible assets. Given that many small businesses have increased their online presence during the pandemic, increasing international tensions could pose a potential risk to small businesses regardless of their location. FSB proposes that the Government assess whether to extend the Pool Re cover to intangible assets to reflect this. This could also help to drive awareness and understanding that terrorism poses risks not only to premises or assets but also through digital means.

12 FSB, Small business as usual, November 2017
13 Pool Re, Launch of Information Sharing Platform Project with Met Police, 2019
14 HM Treasury, HM Treasury's review of Pool Reinsurance Company Limited: Final Report, March 2022 [PDF]

Trade credit insurance

Trade credit insurance typically provides protection to a policyholder against non-payment of accounts receivable, due to the failure to pay an invoice after the due date has passed. Credit insurance seeks to remove the credit risk from the policyholder's balance sheet, thereby improving their profit and loss accounts.

Small businesses highlighted affordability and access issues around this form of cover, which may explain why only 2 per cent of small businesses report having trade credit insurance.

> **"Companies that had loans and even Government-backed bounce back loans on their balance sheets have struggled to obtain trade credit insurance. Some of the quotes that we have seen have been more than three months' worth of invoices, so it was not worth getting the cover. For those that had the cover in place, claims have been difficult to make, as insurers would not pay out if the invoice was incorrect or if they had not been notified within a set timeframe."**
>
> FSB member, Financial services, East Midlands

Research by the Bank of England shows that small business levels of debt have more than doubled since the beginning of the pandemic, in part driven by Government-backed loans.[15] With numbers of insolvencies and business closures likely to rise as well given challenging trading conditions, some small businesses have found it difficult to obtain insurance.

> **"After permanently shutting a shop and liquidating one of my businesses I was refused insurance by 99% of companies for a number of reasons. One insurer refused because I sell to the EU, another because a high percentage of sales goes to North America, a couple because of the value of the stock now held at home. However, most said it was because of the Creditors' Voluntary Liquidation. Only one company would insure me, so I was forced to accept a premium increase of 65% so my business would be insured. I was offered an even higher premium for liability if I wanted to continue to sell to North America."**
>
> FSB member, Retail, London

A quarter of small firms sell their goods, products, or services overseas. International trade opportunities remain central to small businesses' ability to innovate and grow. It is critical for appropriate conditions to be in place to encourage and support small businesses in their exporting journey. Political risk is also a factor in supply chain vulnerabilities, and may have been exacerbated by Brexit, wider macroeconomic and political tensions, and other uncertainties in international markets.

15 Bank of England, The impact of the Covid pandemic on SME indebtedness, November 2021

According to FSB's SBI data for Q1 2022, exports of goods have slightly fallen in the last three months and only around one in 10 small businesses expect this to rise over the next three months. Appropriate and affordable trade credit insurance could provide some degree of protection and encourage small businesses to take up international trade, promoting post-pandemic economic recovery. FSB supports the development of flexible trade credit insurance options for small businesses.

Recommendations

- **UK Government should assess whether to extend the Pool Re cover to include intangible assets in the event of a terrorist cyber-attack.** With the increasing number of small businesses increasing their online presence during the pandemic, an extension to the Pool Re cyber trigger to cover intangible as well as tangible assets in the event of a terror-driven cyber-attack should be considered. It could help to protect small businesses, bring the scheme in line with the cyber risks that businesses face and improve business engagement and awareness. This may require collaboration with insurers which provide existing cyber policies to understand better how such a risk could be incorporated into policies.
- **The insurance industry should continue to develop flexible trade credit insurance options for small businesses and work together with a range of stakeholders including FSB to help raise awareness of and access to such options.** Only 2% of small businesses report buying trade credit insurance. While there are some options in the market for small businesses to cover lower invoice amounts, for example pay-per-invoice policies, more focus on simplifying and developing more flexible options as well as raising awareness would improve access to trade credit insurance for small businesses.
- **UK Government should work together with insurers and the FCA as the regulator to agree specific conditions for forms of Government support that should not be taken into account when calculating business interruption insurance (BII) claims.** During the pandemic a number of insurers had deducted Government-backed loans and grants from BII pay-outs, leading to a period of uncertainty for small businesses. While there is understanding across the insurance industry on the forms of support that should not be taken into account normally, during unprecedented events and particularly in situations where grants could not have been anticipated there should be clear guidance issued to avoid inconsistency. This could be mitigated in the future by agreeing to conditions under which support should not be taken into account by insurers when calculating claims.

PROFESSIONAL INDEMNITY INSURANCE

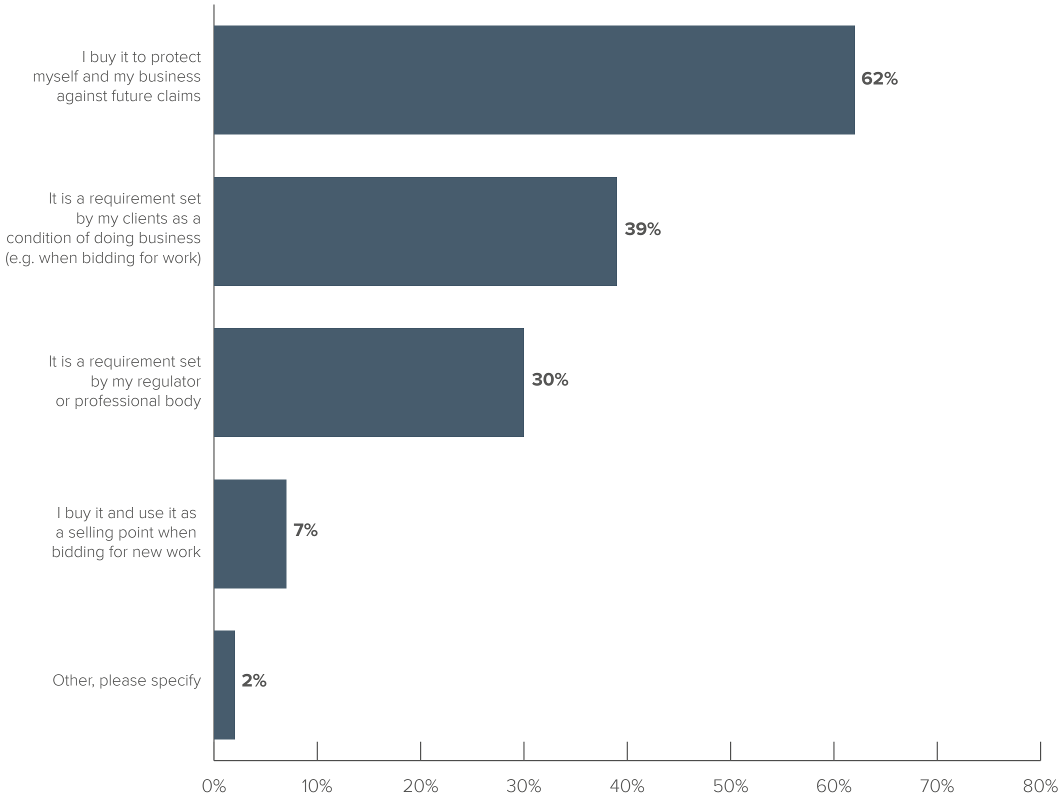
Professional indemnity insurance (PII) is a form of liability insurance. It provides small businesses and the self-employed with an indemnity against claims or losses arising out of negligent acts, errors, or omissions connected to the insured professional practice.

PII typically also extends to the acts, errors, and omissions of past employees. PII is a requirement for professions such as accountants and architects, but PII should be held by any individual or business that provides advice, designs, or services in a professional capacity.

Almost half (47 per cent) of small businesses report having professional indemnity insurance. Of those, 39 per cent say that it is a requirement either set by their clients as a condition of doing business and 30 per cent say that it is a requirement set by their regulator or professional body. A majority (62%) of small businesses with PII buy it to protect themselves against future claims. It is evident that a significant number of small businesses rely on PII to conduct their day-to-day business operations.

Figure 6: Reasons stated by small businesses for purchasing professional indemnity insurance

Source: FSB Insurance and Finance survey 2022



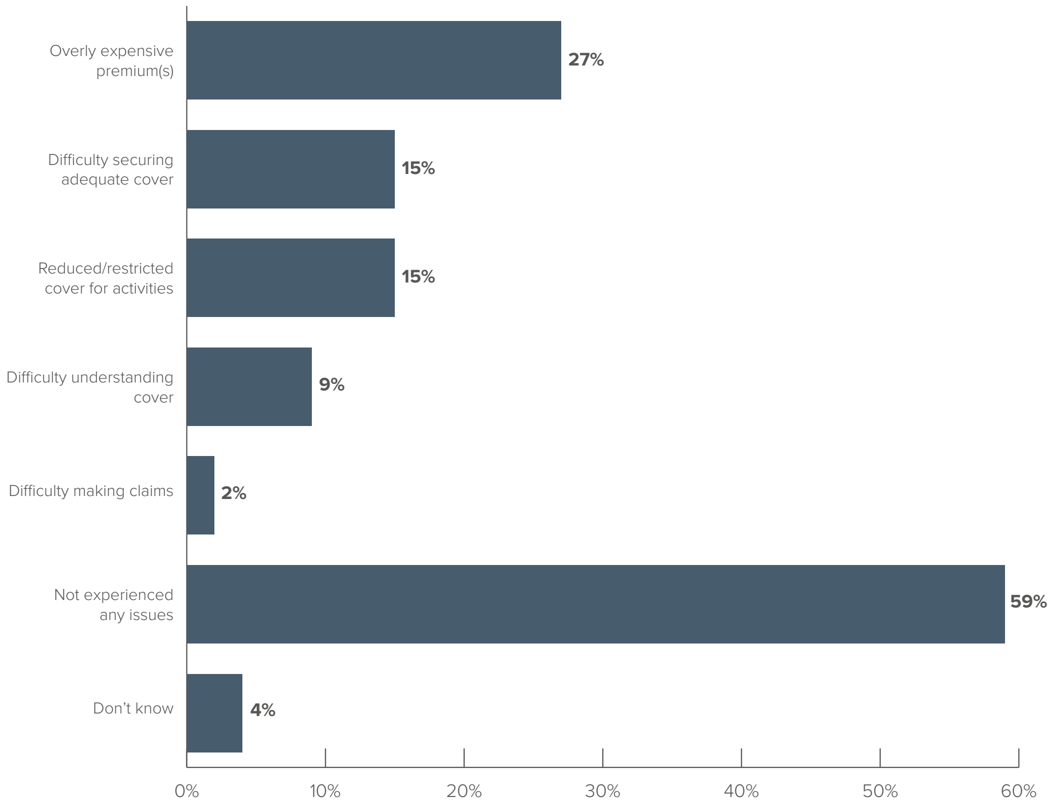
Hardening of the market

The Grenfell fire disaster in 2017, the collapse of Carillion in 2018, and the COVID-19 pandemic have all contributed to a hardening of the PII market, with significant premium increases, reduction of cover, and a general lack of insurers willing to cover some sectors due to high perceived risks.

Of those small businesses who state they have PII, over a third (37 per cent) say that they have experienced issues with their policy. The most common issue is overly expensive premiums (27%), rising to 36 per cent for small businesses in the professional and scientific sector. Our research also shows that small businesses that report purchasing PII because it is a requirement, either set by their clients, regulator or professional body, are more likely to experience overly expensive premiums (81%) than those that report purchasing PII for other reasons (48%). This combined with significant increases in the cost of doing business is particularly damaging to small businesses, as the inability to obtain cover can have an impact on businesses' ability to continue trading.

Figure 7: Issues reported by small businesses with professional indemnity insurance

Source: FSB Insurance and Finance survey 2022



PII operates on a ‘claims made’ as opposed to ‘losses occurring’ basis. This means it is the PII policy which is in place at the time the claim is made against the policyholder which matters, not the insurance policy which was in place at the time of the events giving rise to that claim. While this is in line with many other countries across the world, a change to a losses occurring basis would take away the uncertainty of claims made under later policies which might exclude certain kinds of claim, or have a time limit on claims relating to past activity.

A market study into PII could help to assess and identify not only issues associated with market hardening, including any sector-specific issues, and could also identify how insurers perceive the market – is it seen as a whole market or as many different segments/sectors, for example. This would help to identify whether PII is more likely to harden than other mandatory insurance types such as employers’ liability insurance due to perceived risks, differences in regulatory requirements between sectors, and whether these issues result in a size penalty for businesses. A market study could also look into the impact of offering PII on a claims made versus losses occurring basis as described above.

The limit of indemnity determines the maximum amount the insurer will pay, and some small business owners have reported insurers offering lower limits of indemnity for higher premiums on renewal. Our research found that 15 per cent of small businesses experienced reduced and/or restricted cover for activities when dealing with PII. Over one in seven (15%) also experienced difficulties in securing adequate cover.

> **“We have seen around a 25% increase in insurance premiums since last year, and I would say that over the last five years the premiums have increased by over 100%. We are not able to offer basement extensions as the cover is almost impossible to get, and the cost of getting additional insurance would increase premiums by tenfold. This has led to us outsourcing this work where possible.**
>
> **Insurers are also offering lower limits of indemnity for higher premiums than before and policies now have fire safety exclusions, meaning that fire safety risk is no longer covered for even historic projects. This combined with the restrictions on builds of more than five floors due to the EWS1 form requirements has led us to not taking on certain jobs.”**
>
> FSB member, Architecture firm, North West

For small businesses, premium increases and higher excesses can cause a lot of anxiety around financial stability and have a detrimental impact on their ability to conduct business. Therefore, it is concerning that 62 per cent of small businesses that have PII report that their premiums have increased in the last year, rising to 71 per cent of small firms in the professional and scientific sector.

The majority of small firms (37%) report an increase in in their PII insurance premiums of 10 per cent or less, and 14 per cent report that the increase has been between 11 and 25 per cent over the last 12 months.

A competitive market for insurance is critical in providing businesses with value for money and choice. A hard market, including exclusions and restrictions imposed in cover, driven by an increased number of claims in certain sectors, or additional regulatory requirements for professionals – such as EWS1 forms[16] – can have a detrimental impact on small businesses and their ability to operate. While the FCA requires insurers to report on claims ratios for consumer home and motor insurance markets and some associated products, there is no requirement to report on claims for commercial insurance products.

The FCA should extend general insurance value measures reporting requirements to PII, and consider doing so for other commercial insurance products. The nature of the claims should also be included, in order to help insurers, brokers and their customers to make better assessments of the state of the market. Reporting on claims history on commercial insurance products could help to identify issues in certain sectors and avoid blanket exclusions where not necessary; it would also help the regulator and the insurance industry to offer flexibility in the event of a hard market for the provision of insurance.

Small firms may not require the minimum mandatory level of cover set by regulators or professional bodies in order to conduct the majority of their business if they carry out lower-value work; therefore, in the event of a hard market where such cover is particularly difficult to obtain, there should be some flexibility in allowing businesses to conduct their activities with cover in place that reflects the needs of their business.

FSB proposes that this should also be reflected in any regulatory requirements set by sector-specific regulators and professional associations which require the purchase of PII as a condition of being able to practise. The Government is well-placed to convene a discussion between relevant sector-specific regulators and professional associations on such requirements, to help inform a more proportionate and flexible approach. The needs of small businesses must be considered so that they are not disadvantaged by mandatory minimum levels of PII cover that are required in order to practise, as these can often act as a barrier due to making up a higher proportion of their turnover.

The Government is set to launch an indemnity scheme to support the completion of EWS1 forms in 2022. This will help to alleviate some of the pressures with obtaining insurance for the purpose of fire risk assessments and has the potential to ease claims on insurers. However, further intervention may be needed.

16 EWS1 forms or external wall fire review forms help with the valuation of high-rise buildings with cladding.

CASE STUDY

"We provide health and safety consultancy services which includes general consultancy support for businesses, training, health and safety risk assessment, fire risk assessment, water safety, etc. We employ 70 people, the majority of which are home-based. We work with clients in the property sector and many clients that own or manage a portfolio of properties. These clients use us to complete British Approvals for Fire Equipment (BAFE) fire risk assessments and other compliance assessments of their properties.

In 2020, the insurance premium for the company was £19,500 for professional indemnity, and private and public liability as well as some other types of insurance.

In 2021, our existing insurer pulled out of the market and there have been some ongoing challenges in the sector generally. We shopped around and got a new quote for £215,000 for the same level of cover and types of insurance – this is a more than ten-fold increase. We have tried to make alternative arrangements and search around; however, we have not been able to find anything better.

Various brokers have explained that there have been some unintended costs for insurers and that they have been moving out of high-risk markets. There have also been a number of unintended consequences in our sector following Grenfell. Insurers have not been flexible with application forms and have not assessed company risks on a case-by-case basis."

FSB member, Health and safety consultancy, Wales

PII is also often a requirement in public sector contracts, alongside public liability and employers' liability insurance. PII requirements can often be disproportionate, in part due to the indemnity limits that are required to make a successful bid for a contract. Recent FSB research found that only one in five SMEs has bid for a public sector contract in the last three years, rising to two in five SMEs in construction.[17] Many SMEs see the public sector contract bidding process as complex. The differences in procurement practices across Local Authorities, and often a one-size-fits-all approach in communicating opportunities to large as well as small businesses, can impede small businesses' ability to access opportunities.

Figures released earlier in 2022 show that there has been slow progress on growing the share of Government spending on procurement contracts going to SMEs between 2020 and 2021, with only 26.9 per cent of total spend going to them.[18] This is an increase of only 0.2 per cent on the

17 FSB report, Small Business Access to Public Procurement, October 2021
18 Gov.uk, Central government direct and indirect spend with SMEs, 2020 to 2021, 26 May 2022

previous year and significantly below the Government's target of 33 per cent by 2022.

While there has been a slow and steady increase in SME procurement and an effort by the Government to encourage more small businesses to place bids on public contracts, there are still significant barriers to overcome. In the last three years, 89 per cent of public sector contracts applied for by SMEs were below £100,000, and only 10 per cent applied for a contract above £100,000. In order for small businesses to be able to be able to grow and access higher-value contracts directly or indirectly, it is imperative for liability requirements to be proportionate at the point of application and throughout the supply chain, as disproportionate or unlimited liability requirements can often act as a barrier. Liability should take into consideration the value of the contract and reflect this in the required level of PII in order to be proportionate.

Recommendations

- **The FCA should launch a market study into PII and consult on the proposed remedies.** This could help identify problems and remedies in relevant sectors. The market study could explore the reasons for market hardening, whether these reasons impact some businesses more than others, and examine the value of offering PII on a losses occurring rather than claims made basis. Our research shows that those small businesses that buy PII because it is a requirement are almost twice as likely to report overly expensive premiums than those that buy it for other reasons. This highlights the need for an assessment of the market in more detail, including whether there is a disproportionate size penalty when it hardens.
- **The FCA should extend its general insurance value measures reporting requirements to PII, and consider extending them to a wider selection of commercial insurance products bought by small businesses. In addition to this, reporting requirements should be expanded to include information about the nature of the claims, so that insurers, brokers and their customers can better assess the state of the market.** Current reporting requirements apply to the consumer home and motor insurance markets, and some associated products. We believe that there would be value in extending reporting requirements to commercial products as well as providing more detailed information on claims. While this will not resolve hard market issues on a broader scale, this measure might help prevent blanket exclusions and prevent insurers pulling out of whole markets.
- **UK Government should convene discussion with relevant sector-specific regulators and professional associations, to ensure that PII requirements that are imposed as a condition of being able to**

practise are assessed so they do not disadvantage small businesses. Mandatory minimum levels of PII cover can act as a barrier to entry for small firms, and PII premiums will often make up a bigger proportion of their turnover than for larger firms. Minimum requirements set by sectoral regulators should be stress-tested on a regular basis to assess their impact on small businesses and their ability to compete.

- **UK Government should use the Procurement Bill to remove barriers for SMEs in accessing public procurement opportunities. This should include commitments not to impose unlimited liability for public contracts, to share risk reasonably, and to ensure that both PII and public liability insurance requirements in public contracts are proportionate to the size of the contract.** With the majority of small businesses bidding for lower value contracts, proportionality to the size of the award is key. Small businesses should not be discouraged or disadvantaged by requirements set out in public sector contracts.
- **UK Government should take a shared risk approach with suppliers in relation to public contracts, and ensure that requirements are not simply passed down the supply chain. This would also help smaller firms innovate in the public sector, by giving them more freedom and lower levels of risk to find new solutions to old problems.** Currently, small businesses are sometimes prevented from taking on additional commercial activity indirectly where requirements are passed down regardless of the fraction of the work being undertaken by the small business in question.

CYBER INSURANCE

Cyber insurance provides cover against the consequences of a cyber event, which may take the form of a cyber-attack or an accidental cyber failure. Cyber risks have gained increasing attention over the last few years, due to increased adoption of digital technologies by businesses, and increased business presence online.

Previous FSB research found that 16 per cent of small businesses developed a new online channel or increased their online presence during the first half of the pandemic, and 24 per cent increased or adopted new digital technologies.[19] It is, therefore, likely that even more small businesses were exposed to cybercrime than the one in five (20%) small firms in England and Wales who had experienced it prior to this period.[20]

Cyber risks are not solely limited to data loss. A cyber incident could lead to a wide range of losses, including business interruption, theft, property damage, blackmail, and even personal injury. Despite these risks, the uptake of cyber insurance by small businesses remains relatively low. Our research found that only 10 per cent of small businesses say they have cyber insurance (including GDPR/data breach insurance). This is relatively low in comparison to 50 per cent of small firms and 42 per cent of micro businesses that reported having some form of cyber insurance according to research by the Department for Digital, Culture, Media and Sport (DCMS).[21]

Previous FSB research found that the most common types of cybercrime were phishing (51%), malware (36%), and processing fraudulent payments online (29%).[22] The awareness of the possible threats and risks of cybercrime is growing amongst small businesses:

> **"We're looking into cyber insurance. Unfortunately, at renewal, we did have an attack, sort of denial attack, and our business Amazon account was hacked. We didn't have to claim because we managed to sort it out fairly quickly, but it made me think that cyber insurance sounds like it's just another opportunity for the insurance company take money out of you, but certainly in this day and age, it is quite important to have. Because if we'd been hacked, we can't get into our customer databases, or if some of that data had been taken from us, we would have had a problem with the data protection people."**
>
> FSB member, Wholesale and retail, East Midlands

Of those small businesses that do have cyber insurance, it is concerning that nearly four in 10 (38%) say that they don't know what their policy includes. This could be because cyber policies are often added to a general small business insurance package.

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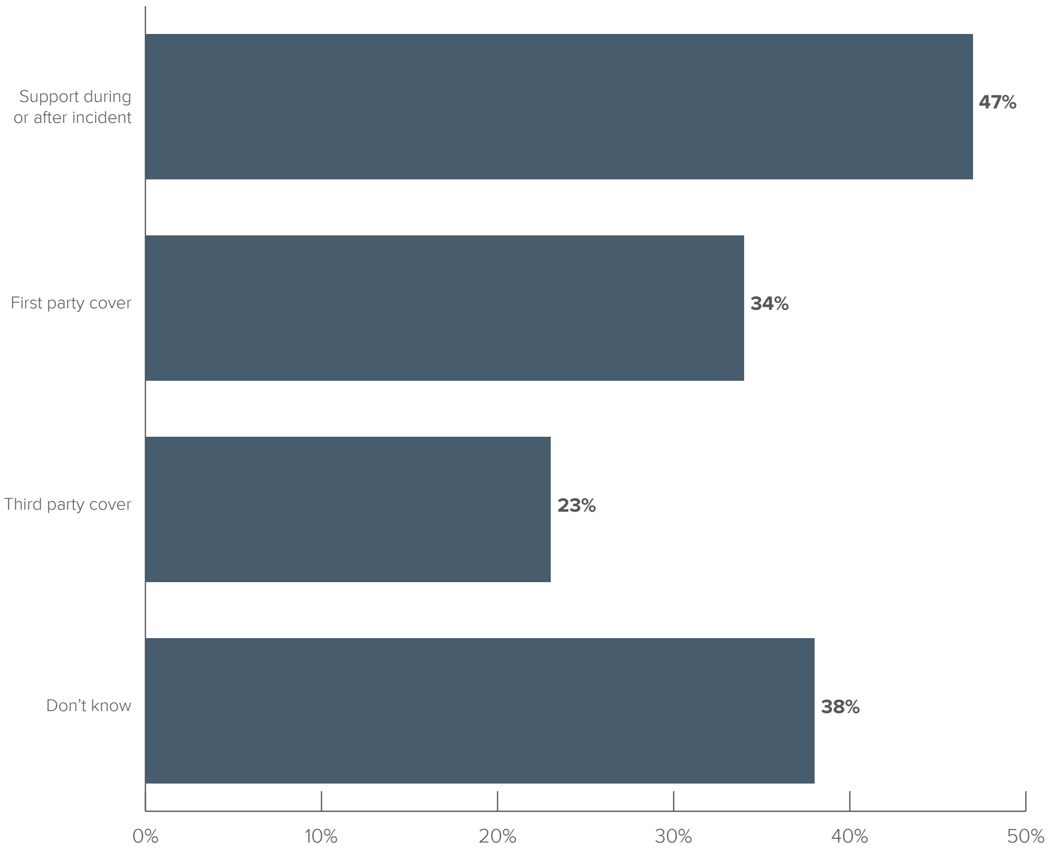
19 FSB report, New Horizons: How small firms are navigating the Covid 19 crisis, May 2020
20 FSB report, Calling time on business crime, October 2019
21 DCMS, Cyber Security Breaches Survey 2022, March 2022
22 FSB report, Calling time on business crime, October 2019

Figure 8: Small business awareness of what their cyber policy includes

Source: FSB Insurance and Finance survey 2022



There are no established forms for cyber insurance either in standalone cyber polices or where cyber insurance is a component part of a package policy. An illustration of this is that there are around 50 definitions of 'computer system' in cyber policies in use in the London market. This makes comparisons between different policies challenging, and makes it harder for small business owners to understand the scope of cover that is required when purchasing policies. There are, however, some common themes.

Cyber insurance can be bought either as a specific policy on its own, or is also commonly added on as part of a wider insurance policy. It can cover a business's own assets, business interruption, and extortion, and can cover the assets of others such as the business's customers in the event of denial of access to systems, or privacy breaches. Some policies also include support during or after an incident, as well as helping to drive good cyber hygiene through support and advice. In some cases, businesses can benefit from a reduction in premiums if they have appropriate measures in place. It is welcome that the British Insurance Brokers' Association aims to launch a guide to cyber insurance for SMEs in 2022, outlining the vital role of cyber insurance in mitigating risk, thus helping to improve consumer understanding.[23]

Cyber insurance can play a significant part in cyber risk mitigation. 'Managing cyber risk' and 'expertise on breach recovery' are among the most-cited reasons for businesses taking out cyber insurance, highlighting the potential role that insurers can play in helping small businesses to manage, mitigate, and recover from cyber-attacks. FSB research suggests those small firms that purchased cyber insurance are more likely to obtain or renew their policy through a broker (66%) compared with other insurance types (62%).

Cyber resilience

Investing in cyber resilience is key to being able to protect a business. The cost of a cyber-attack is not only financial; stolen data and offline systems can also lead to reputational risk and a loss of consumer trust.

Previous FSB research has found that nine in ten small businesses in England and Wales have invested in at least one cyber resilience measure.[24] However, the extent of those measures varies by business size and sector, with businesses with more than 20 employees more likely to invest in more measures than micro businesses, and those in the information and communications sector more likely to invest than in any other sector.

While many of the defensive measure for businesses to help prevent cyber-attacks come at a cost, there are free resources available. The National Cyber Security Centre provides training and guidance aimed at small businesses to improve their cyber resilience. However, previous FSB research has found that only 4 per cent of small businesses have sourced advice from the centre as part of their defensive measures.

The new National Cyber Security Strategy 2022 recognises the cyber security knowledge gap between small and large businesses, and aims to improve basic knowledge of cyber security through tailored support and guidance for sole traders and small businesses to help manage cyber risk, as well as developing commercial offerings around Cyber Essentials, making it easier for small businesses to access tailored advice. FSB welcomes this; however, further improvements could be made in order to raise awareness of cyber risks, including through campaigns similar to Cyber Aware aimed at small businesses.

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23 British Insurance Brokers' Association, 2022 Manifesto Managing Risk, p29, January 2022
24 FSB report, Calling time on business crime, October 2019

CASE STUDY

"Small businesses often think that because they are small that they have no data, and hackers will not be interested in them, but that is not the case. Hackers and scammers target the size of vulnerabilities in the business and not the size of the business itself. In my experience only 5 per cent of businesses are adequately protected. Having cyber insurance but no other effective measures in place is like securing your front door but leaving the windows wide open – the two must go hand in hand.

There are five key areas that a small business should focus on:

1. **Computer security against unknown threats**
2. **Secure storage and management of passwords**
3. **Enhanced e-mail security to take risk away from the user**
4. **Backing up data to mitigate the risk of data loss**
5. **Regularly participating in cyber education/awareness programmes.**

It's 'when' and not 'if' when it comes to cyber-attacks. With the average cost of a cyber-attack to a business being around £8,500, it is critical that small businesses are adequately protected."

Francis West, FSB Policy Champion for Cyber Security

Recommendations

- **Governments across the UK should raise awareness of the cybercrime risks to small businesses through campaigns similar to Cyber Aware, and help signpost to relevant information through support services like Business Wales.** The 2022 National Cyber Security Strategy sets out the government's plan to mitigate the risk of cyber-attacks on individuals and businesses. For small businesses, the strategy recognises the need for tailored and targeted guidance and tools to be made available in order to improve understanding and awareness of cyber security. While the tools and guidance are available, our data shows that very few small businesses access this information. Some of the reasons cited for this are lack of awareness of the available information and understanding of cyber risk.

NET ZERO AND INSURANCE

Small businesses are keenly aware of the need to act on climate change; however, many are resource-poor in terms of time, expertise, and finances.

Zero emission vehicles (ZEVs) and changing transport habits are also undoubtedly critical to achieving net zero, and while the uptake of these options is encouraging, upfront cost and insufficient infrastructure are still significant barriers for most day-to-day businesses. For the insurance industry, a key challenge is to keep up with the pace of change in products and technologies that will help businesses on their journey to net zero, while closing any gaps in cover.

FSB's *Accelerating Progress: Empowering small businesses on the journey to net zero* report found that nearly a third of small businesses say that they have a plan to transition to net zero and have made changes in their business as a result.[25]

Insurers should support businesses in reaching their net zero targets and mitigate risks that are evolving as a result of climate change. ABI's Climate Change Roadmap sets out the role insurers can play in helping the Government deliver on its Net Zero Strategy.[26] The roadmap includes suggestions for insurers to help customers to make sustainable choices, for example choosing an electric vehicle after a conventional vehicle is written off, or replacing a gas boiler with a sustainable alternative. This could also be used to encourage small businesses to make more sustainable choices by way of reduction of the cost of insurance through premiums or excesses, and help to mitigate some of the associated costs. Insurers also have a role to play in raising awareness of climate risk.

Electric vehicles

In November 2020, the UK Government announced that all new petrol and diesel car sales will be phased out by 2030. By 2035, all new cars and vans must be fully zero-emission at the tailpipe. Although electric vehicles are becoming more common domestically, only 9 per cent of small businesses say they have or will have switched all or some of their fleet to ZEVs by 2030.

Our 2021 research found that 8 per cent of small businesses have already installed an electric vehicle workplace charging point. In addition, almost half (46%) of small businesses state that ZEVs are currently too expensive, with 16 per cent concerned about the lack of a second-hand market for ZEVs. The costs also pose challenges for insurers to find cost-effective solutions for claims management. As ZEVs and their parts are expensive, there is potential to explore how additional costs could be topped up at the point of a claim to help smaller businesses transition to ZEVs, particularly those with smaller fleets or sole traders.

25 FSB report, Accelerating Progress: Empowering small businesses on the road to net zero, November 2021

26 Association of British Insurers, Climate Change Roadmap, June 2022

The UK Government has also raised the importance of the second-hand electric vehicle market as "critical in the UK's transition to zero emission vehicles";[27] however, a second-hand market organically grows over time. Lack of available data on ZEVs, in terms of driving behaviour, battery life, costs of repair and availability of appropriate technology for repair and diagnosis, all add challenges and costs to assessing the risk when calculating insurance premiums. This is particularly the case for new manufacturers of electric vehicles, where parts are limited and there is uncertainty around their longevity.

However, the price of ZEVs is not the only barrier to wider adoption. A third (35%) of small firms say the lack of charge points is a reason why they have not taken any steps with regards to their business's transport habits – with 43 per cent in rural areas citing this as a reason. There are also wider risks to be considered in relation to ZEVs and charging points. Associated fire risk as well as potential cyber vulnerability could have an impact on business premises and associated insurance products.

Environmental changes to business premises

Improving energy efficiency and any other environmental changes such as installing solar panels in business premises will also be vital in helping businesses reach their net zero goals. Some steps that small businesses could take are more accessible than others. For example, switching to a renewable energy tariff or to energy-efficient appliances are significantly lower-cost than upgrading the insulation of the premises or installing solar panels. Both buildings and contents insurance could be affected by any changes to premises; therefore, it is critical to notify insurers of any changes or improvements made, in order to reduce the possibility of underinsurance and to provide adequate protection from potential risks.

One of the key barriers that small businesses face in relation to making environmental changes to businesses premises is in restrictions in their tenancy and lease agreements. Our recent research found that a fifth (20%) of small business owners say that their landlord not allowing the installation of solutions to boost energy efficiency is the key factor in not making changes.[28] More could be done to incentivise collaboration between landlords and tenants, to allow small businesses to take ownership of their low carbon improvements. While awareness-raising by the insurance industry is welcome, the cost challenges for any environmental changes to business premises remain.

For insurers, steps must be taken across the full scope of their operations

27 Department for Transport and Office for Zero Emission Vehicles, Transitioning to zero emission cars and vans: 2035 delivery plan, July 2021

28 FSB report, Accelerating Progress: Empowering small businesses on the road to net zero, November 2021

including the supply chain to meet the 50 per cent emission reduction target by 2030. This includes those that provide support to businesses and organise repairs and replacement. ABI estimates that as much as 90 per cent of the insurance sector's emissions will come from wider supply chain,[29] and with many of those in the supply chain being small businesses, it is critical that they are supported by the industry to transition to net zero. Otherwise, small firms may be forced out of supply chains altogether.

Recommendations

- **The insurance industry should have a role in raising awareness and incentivising businesses to make sustainable choices.** For example, lower premiums or excesses could be deployed to encourage businesses to act on climate change, and information could be provided to small businesses on the steps they can take to reduce their climate risk. This would be in line with the model used for cyber insurance where insurers reduce premiums for good cyber hygiene. This would help to reduce the cost for small businesses in transitioning to net zero, thereby tackling some of the financial barriers that small businesses experience in relation to making more sustainable choices and aiding their future resilience.

29 ABI, Climate Change Roadmap, June 2022

METHODOLOGY

The research that this report is based on was two-fold. It consisted of a survey of 819 small businesses, along with sector-specific focus groups and one-to-one interviews to better understand the experiences of FSB members nationwide in relation to their experiences of claiming on and obtaining insurance for their business. Members were asked to participate in the research through email invitations.

The survey was administered by the research agency Verve and was in the field from 10th-26th January 2022. The survey received 819 responses and the findings were weighted to make them representative for FSB membership. All percentages have been rounded up to the nearest percentage point, which is why may some of them may not add up to 100 per cent.

The focus groups took place via Zoom, and the majority of participants were sourced through recontact data from the survey, while others were from appeals for participants within the FSB membership via email. The participants were purposefully drawn from a number of regions. The one-to-one semi-structured interviews were conducted with members via telephone or Microsoft Teams, between January and February 2022.

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