Reading the Riot (Damages) Act - what it means to you

Insurers are closely watching a legal case relating to the riots as this may affect the position on consequential losses. The case, Mitsui Sumitomo Insurance Co (Europe) Ltd, Royal and Sun Alliance Insurance plc and others v The Mayor's Office for Policing and Crime, concerns the damage sustained at the Sony distribution warehouse in Enfield during the riots.

The judge, Mr Justice Flaux, ruled that consequential loss was not covered by the Act but his decision was overturned at the Court of Appeal, placing state compensation for consequential loss as well as physical damage within the remit of the Riot (Damages) Act.

The widespread rioting that took place in August 2011, resulted in insurers paying out around £200 million in claims to households and businesses affected by the riots. But the extent of the rioting - which, with more than 5,000 crimes committed is regarded as the worst for a generation - also served to highlight the need to update and clarify the legislation that determines compensation, the Riot (Damages) Act 1886.

What is the Riot (Damages) Act 1886 and how does it affect insurance?

The Riot (Damages) Act 1886 sets out how individuals, households and businesses are compensated by the police in the event of losses resulting from riots.

In practice, an insurance customer who suffers a loss in a riot would make a claim for damages from their insurer, who would then seek compensation from the police. This ability for an insurer to claim compensation back from the police ensures that riot insurance is widely available and is not reflected in the policy premium.

However, the Act is now more than 125 years old and society has moved on considerably - for example cars, which can be vandalised in riots, had not even been invented when the Act was conceived and therefore are currently not in scope for compensation - so it is widely accepted that it is in need of an update.

How is it being reformed?

The government commissioned an independent review of the act by Neil Kinghan to bring it up to date and clarify elements of the legislation. This was reported in September 2013, and set out 20 recommendations, which form the basis of a consultation.

What are the recommendations?

The recommendations include the creation of a riot claims bureau, staffed by loss adjusters and insurance experts to manage claims in the event of widespread riots; a change in riot compensation payments from an old-for-old basis to a new-for-old basis; and the extension for compensation to damage to cars and vehicles.

Two of the recommendations are particularly relevant to the insurance industry and its customers. These are the proposal to limit compensation under the Act to those businesses with an annual turnover of less than £2 million and that business interruption insurance (which also isn't mentioned in the Act) is formally excluded.

How does the recommendation of a cap on compensation affect insurers?

Removing insurers' ability to claim back compensation from the police for businesses with annual turnovers in excess of £2m a year will affect the cover insurers provide.

Insurers may need to fully underwrite the riot risk for clients where the annual turnover is over, or close, to £2m a year. As well as resulting in a charge for cover, this may mean the introduction of limits on the cover available.

How will this affect insurance customers?

This recommendation would mean that only the smallest companies would still be able to access compensation under the Act. For example, figures from the Association of British Insurers (ABI) show that businesses with a turnover of less than £2 million only accounted for around 9% of the total value of commercial property material damage claims in the 2011 riots. Businesses with an annual turnover close to or in excess of £2 million could see the cost of cover increase or terms and limits applied. Some, especially those in higher risk areas or with a history of riot damage,

may even struggle to get cover. Some businesses may simply choose not to purchase riot cover, and then find themselves unprotected if a riot event occurs.

It could also affect some of the areas where rioting took place. For example, in its response to the consultation, the ABI states that the imposition of a cap could act as a disincentive for some larger firms to locate in some areas. This could potentially turn areas with higher riot risk into further deterioration.

How does the recommendation to remove consequential losses affect insurers and customers?

Whether or not consequential losses are covered by the Act has always been a bit of a grey area with some police authorities already turning down compensation claims from insurers. But, if consequential losses fell outside the Act, insurers would need to consider their stance on business interruption insurance. This would push up the cost of cover, especially in higher risk areas, and could lead to the application of terms and limits on cover. These costs would then be passed on to customers.

The insurance industry is uncomfortable with this recommendation and has pointed out that even those businesses covered by the Act but with inadequate or no business interruption insurance cover could suffer from loss of trade, or go out of business even though their property damage is covered under the Act.

What happens next?

The recommendations were put out for consultation in June and more details of the reform of the Act - and the implications for the insurance industry and its customers - is expected later this year. As these are announced, we will keep you informed of the implications.