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Business Interruption Insurance Compendium

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Business Interruption Insurance Compendium

Executive Summary

This report provides a general introduction, a brief summary and a list of references that include various articles, papers, program proposals and legislative notes that provide additional insight into the following topics related to Business Interruption Insurance and the effects of the coronavirus (COVID-19) pandemic on its current and future state of coverage:

- General Information on Business Interruption Insurance
- Legal Actions
- State and Federal Legislation
- Proposed Private/Public Partnerships for Future Pandemics as they Relate to Business Interruption Insurance
- Impact of COVID-19 on Businesses, Insurers and Reinsurers: Magnitude of Losses and Future Business Interruption Coverage
- Future of Insuring a Pandemic

Please note that each section of this report is not self-contained; the information provided within each section is related to the information provided within earlier or later sections and, therefore, for completeness, should not be reviewed in isolation.

The authors would like to thank the Society of Actuaries (SOA) for their guidance and invaluable contributions to this research, including sharing information during the initial research stages, providing valuable feedback throughout the process, and assisting in identifying industry experts to interview.

Section 1: General Information on Business Interruption Insurance

In general, business interruption (BI) insurance is insurance coverage that replaces business income lost in a disaster[1]. BI insurance is an unusual and complicated coverage. A BI policy is triggered after a physical event has occurred and the insured business has been shut down for a specified period. The insurer then pays the business owner an amount that represents lost profits and some ongoing operating expenses for the duration of the shutdown up to the amount of time or dollar limits specified in the insurance contract. BI claims often take months to be fully settled, as there is an initial waiting period, lost income must be determined, and the closure of the insured business must run its course[2].

Some examples of what could be covered by business interruption insurance include[1 3 4]:

- Income that a business would have earned if operating normally during the time the business is closed.
- Rent or lease payments during the time when the premises were unusable.
- Operating expenses.
- A move to a temporary location.
- Employee wages to help businesses make payroll while the business is unable to operate.
- Business taxes.
- Loan payments.
- Losses caused by damage preventing access to a building. Also known as loss of “ingress/ egress”[5], this coverage applies when a government implements a curfew or other restriction that keeps people away from your business.

Like any other insurance, business interruption insurance has limitations and exclusions. Generally, business interruption insurance will not cover[3 6]:

- *Undocumented income:* It is important to have several months of documented income, particularly if the business is growing, so that the owner can account for the income for which he/ she wants the policy to reimburse. The owner will need to prove that the business suffered financial damage because of the interruption. The owner will need to find out what proof the policy requires and carefully document the affairs.
- *Utilities:* As utilities are typically shut off when a business location cannot be used, they are usually not covered by business interruption insurance.
- *Partial closure losses:* Business interruption coverage does not go into effect if access to the building is limited but not completely eliminated.
- *Losses from closures caused by damages that are not covered:* A business owner cannot receive income coverage for flood damage or earthquake damage not covered under his/her property insurance policy, or for when the business is closed voluntarily.

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[1] Business Interruption Insurance Definition (investopedia.com)
[2] Coronavirus news and updates | III
[3] Common Exclusions to Business Interruption Insurance | Reisen Agency Insurance (reiseninsurance.com)
[4] Do I need business interruption insurance? | III
[5] COVID-19 Business Interruption Suits: An Overview Of Decisions To Date | Goodwin - JDSupra
[6] The “Viral Pandemic Exclusion” Clause in Business Interruption Insurance Policies | Ithaka S+R

- *Closures caused by downed power lines:* Most closures caused by downed power lines from a storm or accident are not covered under a business interruption policy. Power outages are common, and power is usually restored quickly[7] [8].
- *Standard exclusion for viral pandemic:* After the SARS outbreak in 2003, many insurance companies adopted a standard exclusion in their policies for viral pandemics[7] [8].

BI is an optional coverage that businesses can elect to add to basic commercial property insurance. Only about 30%-40% of small and midsize businesses buy BI coverage[9]. Small businesses generally do not buy BI coverage as a stand-alone policy. Larger businesses that purchase more complex insurance packages may buy it separately. Companies that manage large events may buy all-risk policies that include public health closures. An additional specialized coverage that may be either a stand-alone policy or attached to other packages of insurance policies is event cancellation coverage with specified policy provisions. Some more high-profile events such as canceled concerts, sports events, and so forth have been reported with large payouts. Expanding BI coverage to include a new risk (e.g., pandemic virus) will increase the cost of BI insurance policies. The result could be an available expensive coverage with limited numbers of small businesses deciding to purchase it[9].

A typical business interruption insurance clause might read as follows: “We will pay for the actual loss of business income you sustain due to the necessary suspension of your “operations” during the period of “restoration.” The suspension must be caused by the direct physical loss, damage, or destruction to insured property. The loss or damage must be caused by or result from a covered cause of loss”[10].

Standard business interruption insurance does not reimburse policy holders if the business is closed due to a pandemic[11]. Even some all-risk insurance plans have specific exclusions for losses due to viruses or bacteria. Communicable disease riders can sometimes be purchased separately[12].

The business must be closed for a certain period of time – usually 72 hours, but it varies by policy – before one can begin collecting benefits. Most policies will cover any interruptions that last up to 12 months. Each insurer may include different business interruption coverages and exclusions to distinguish itself from the competition[13].

Business Interruption insurance can be inexpensive for a small business, but several factors affect policy costs, including[13]:

- Revenue
- Business classification or industry
- Previous business interruption claims
- Location

[7] Common Exclusions to Business Interruption Insurance | Reisen Agency Insurance (reiseninsurance.com)
[8] The “Viral Pandemic Exclusion” Clause in Business Interruption Insurance Policies | Ithaka S+R
[9] Coronavirus news and updates | III
[10] Eight Key Concepts to Understand in Business Interruption Coverage (marsh.com)
[11] Business Interruption Insurance Definition (investopedia.com)
[12] Communicable Disease Rider in Business Insurance | Insureon
[13] Business Interruption Insurance for Small Businesses | Insureon

A brief Q&A related to Business Interruption Insurance can be found inside the Insureon Small Business Blog[14].

[14] Answers to Your Coronavirus (COVID-19) Business Insurance Coverage Questions | Insureon

Section 2: Legal Actions

The COVID-19 pandemic forced the closure of businesses around the world throughout the course of 2020. An October 2020 survey found that over three-quarters of U.S. small businesses lost revenue due to the pandemic with losses averaging 30%. An additional 37% reported having to lay off or furlough staff. Business interruption (BI) insurance is intended to help keep small businesses afloat in case of a temporary closure. However, only about 40% of small businesses purchase BI coverage and many of those policies have pandemic or virus exclusions[15], such as "Loss or damage caused "directly or indirectly" by "any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease""[16].

The overall policy generally has two coverage provisions. The first is BI, which covers loss of business income sustained due to suspension of business operations due to "direct physical loss" or "direct physical damage". A second is Civil Authority Coverage, which covers loss of business income sustained when access to the insured property is prohibited by order of a civil authority as a result of "direct physical loss" or "direct physical damage" to properties adjacent to the insured property which prevents the insured from accessing the property. By and large, insurers disagree that the COVID-19 pandemic and resulting shutdown orders caused losses that were covered under either of the coverage provisions, and denied these claims. Many businesses responded by filing declaratory judgment actions seeking judicial determinations that their insurers improperly denied coverage[16]. It has been reported that businesses started filing suit against their insurers as a result of coverage denials in March 2020; since then, as of January 2021, an estimated 1,300 COVID-19 business insurance lawsuits have already been filed in courts nationwide[17]. Only a small portion of business owners have found success in the courts[18]. However, despite setbacks, businesses keep suing[19].

So far, judges have dismissed more than four times as many business interruption lawsuits than they have allowed to proceed. Most of the dismissed cases had virus exclusion clauses in the plaintiff's policy[16]. Claims that have been successful in proceeding through the judicial process hinge on insurance policies' ambiguous language surrounding virus exclusions. Insurers claiming that plaintiff's cases do not meet the physical damages requirement for BI coverage have largely been winning court dismissals, according to the Insurance Information Institute. To circumvent the physical damages requirement of BI polices, plaintiff's lawyers are arguing government lock-down orders should trigger BI coverage for their clients[15].

In at least one case, an insured argued that an "ingress/egress" coverage extension — which provides coverage where the insured cannot access the property — should provide coverage for COVID-19 business interruption losses. However, like civil authority coverage, ingress/egress coverage typically requires a showing that physical loss or damage to neighboring property prevents access to the insured's property, and courts have found that no coverage exists under that provision because insureds are unable to make that showing[16].

As of December 2020, two federal district courts (the Western District of Missouri and the Eastern District of Virginia) and two states (New Jersey and North Carolina) appear to have been the only courts to deny an insurer's motion to dismiss based on the court's determination of "physical loss" or "damage"[20].

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[15] Business Interruption & Pandemics RI - Dec. 2020.pdf (naic.org)
[16] COVID-19 Business Interruption Suits: An Overview Of Decisions To Date | Goodwin - JDSupra
[17] Court Finds Restaurant's Insurance Provides Coverage For COVID-19 Business Interruption - AboutLawsuits.com
[18] Court Rules in Favor of Goodwill on COVID-19 Business Interruption Matter | Property Insurance Coverage Law Blog | Merlin Law Group
[19] Insurers Winning Most, But Not All, COVID-19 Business Interruption Lawsuits (insurancejournal.com)
[20] COVID-19 Business Interruption Suits: An Overview Of Decisions To Date | Goodwin - JDSupra

Plaintiffs have also sought to centralize the resolution of hundreds of COVID-19-related business interruption cases in a multi-district litigation ("MDL") (MDL No. 2942). An MDL is a special procedure which applies where cases with "one or more common questions of fact are pending in different" federal courts across the country. The purpose of an MDL is efficiency — to "promote the just and efficient conduct of the actions" — by centralizing all such actions in one district court before the same judge (or panel of judges). On August 12, 2020, the MDL panel largely rejected plaintiffs' attempt to consolidate such cases, finding that there was no commonality between the various defendants and that the cases involved different insurance policies with varying coverage provisions and exclusions[21].

There have not been any decisions on the merits of coverage that have been issued by appellate courts as of the date of this report. Bearing in mind that insurance coverage for these claims will almost always be a matter of state rather than federal law, it likely will take quite some time before any state Supreme Court issues a binding precedential determination of that state's law on business interruption coverage for coronavirus claims. It will take longer still for any majority or consensus view to emerge among the state supreme courts. (However, a consensus is not the standard that policyholders should have to meet; many states recognize that a split in authority is enough to interpret policies in favor of coverage.)[22].

[21] COVID-19 Business Interruption Suits: An Overview Of Decisions To Date | Goodwin - JDSupra
[22] Business Interruption Insurance Claims for COVID-19 Losses (natlawreview.com)

Section 3: State and Federal Legislation

Bills are pending throughout the country that would require insurers to pay for coverage that was never sold and would have far-reaching, significant negative impacts to all consumers and businesses relying on the insurance market to protect them now and in the future[22]. These bills attempt to change every insurance policy issued for loss of use and occupancy and business interruption so that each policy would effectively be rewritten to include coverage for business interruption during the declared state emergency due to the COVID-19 pandemic and mandate insurance policy interpretation regardless of the clear wording of the policy itself, providing a coverage never intended when the policy was underwritten and priced[23].

The National Association of Insurance Commissioners (NAIC) stated that insurance regulators are committed to working at the state and federal level to help mitigate the devastating economic impacts of the COVID-19 pandemic. For example, states have already taken swift action to allow health insurance consumers to access COVID-19 testing without cost-sharing and working to extend access to coverage for consumers where states are empowered to do so. Given the current condition of the financial markets, state regulators and the NAIC are also closely monitoring the financial health of insurers to ensure their continued strength and resilience[24].

Since most of the recent claims by private businesses seeking to recover COVID-19 losses under their business interruption and property insurance policies have typically been denied by their insurers, the consequences have been so severe that businesses' continued existence is threatened, prompting them to urgently request relief from their elected representatives. In an effort to address those requests, state legislators in Louisiana, Massachusetts, New York, New Jersey, Ohio, Pennsylvania and South Carolina have each introduced and are considering proposed legislation that would require insurance companies operating in their states, either temporarily or permanently, to pay out on coronavirus-related loss claims brought by their small business insureds (generally those with less than 100-150 employees) since the beginning of the crisis, without regard to whether the relevant business interruption and property policies actually cover such claims – subject only to the procedural requirements, monetary caps and time limits of those policies. Many of these proposed statutes also permit the insurers to subsequently seek reimbursement from their states for such payouts, subject to the states being able to impose a surcharge back on all insurers selling such policies in their jurisdictions to recoup those reimbursement payments (which the insurers in turn could pass on to their customers later), though it is not clear whether the reimbursements would be total or partial. The constitutional requirements are sufficiently complex, however, and debatable that any state statutes seeking to retroactively impose a "forced" interpretation of insurance policies in this manner will almost certainly be challenged in court immediately upon enactment[25] [26].

In the meantime, several members of the U.S. House of Representatives have introduced proposed federal legislation on this issue that would similarly void any provisions in business interruption or property insurance policies purporting to exclude coverage for COVID-19-related losses and losses resulting from certain other "major events" such as mandatory evacuations, public safety power shut-offs, etc., and require the issuers of such policies to cover such losses. This federal override, however, would apply to all property and casualty insurance policies "provided or made available for losses resulting from periods of suspended business

[23] 2020 Business Interruption Legislation (wsia.org)
[24] NAIC Statement on Congressional Action Relating to COVID-19
[25] Proposed COVID-19-Related Business Interruption and Property Loss Insurance Legislation | Insights | Holland & Knight (hklaw.com)
[26] More States Introduce COVID-19 Business-Interruption Bills (claimsjournal.com)

operations," not just policies issued to small businesses, and it would preempt any conflicting state laws permitting insurers to exclude such coverage[27].

Current federal activity related to Business Interruption includes, but is not limited to, the following[28]:

- Pandemic Risk Insurance Act (created a reinsurance program for pandemics, by capping the total insurance losses that insurance companies would face)[29] [30]
- Business Interruption Insurance Coverage Act (the bill would require each insurer that offers or makes available business interruption coverage to cover losses resulting from pandemics, forced closures or power shutdowns. It would also preempt existing exclusions)
- Never Again Small Business Protection Act of 2020 (the bill would require insurers that offer or make available any business interruption coverage to provide for coverage of losses resulting from interruption of business operations during any declared local, state or federal national emergency. It would require the Department of Treasury to conduct a study on the effectiveness of a federal backstop for excessive losses for insurers and the report would trigger if the legislation becomes effective)
- The Business Interruption Relief Act of 2020 (the bill would establish a fund to reimburse insurers that voluntarily pay claims for business interruption coverage to certain eligible businesses. The claims must be to those with (a) business interruption insurance that (b) includes civil authority shutdowns but (c) excludes virus-related damages)

State activity includes proposed legislation from numerous states, such as: California, DC, Louisiana, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Wyoming, Oregon and Illinois. Since the beginning of 2021 state legislative sessions, some of 2020's bills have been refiled and a few states are filing new bills[27] [31]. To date, no state has enacted any legislation, but the bills are making their way through the committee process. It is yet to be determined whether these bills will be enacted into law, and if so, whether they will withstand constitutional challenges. With the increased financial burden placed on insurers to cover losses secondary to COVID-19, the question remains whether or not insurers can find a way out[32].

The NAIC website contains state communications (bulletins, notices, and webpages) regarding any developments related to Business Interruption Insurance[33].

Additional information on the state of business interruption legislation can be found in the legal blog from Lathrop GPM insurance recovery and counseling law practice for businesses[34].

[27] Proposed COVID-19-Related Business Interruption and Property Loss Insurance Legislation | Insights | Holland & Knight (hklaw.com)
[28] 2020 Business Interruption Legislation (wsia.org)
[29] Pandemic Risk Insurance Act and the Future of Business Interruption Insurance - Insurance & Reinsurance (insurereinsure.com)
[30] Responding to the COVID-19 and pandemic protection gap in insurance (oecd.org)
[31] More States Introduce COVID-19 Business-Interruption Bills (claimsjournal.com)
[32] COVID-19 Business Interruption Insurance Litigation Guide - Expert Institute
[33] Business Interruption & Pandemics RI - Dec. 2020.pdf (naic.org)
[34] Legal blog from Lathrop GPM insurance recovery and counseling law practice for businesses: Lathrop GPM

Section 4: Proposed Public/Private Partnership for Future Pandemics as it Relates to Business Interruption Insurance

Some insurers have proposed public-private solutions to address the issues encountered with COVID-19 for future pandemics. Chubb Limited is one such insurer. According to Chubb:

"Some risks can create losses so great that they are not insurable in the private insurance market without substantial government support, including catastrophic terrorism, nuclear accidents and pandemics. These catastrophic events can cause massive economic disruption as governments struggle, as they have in response to COVID–19, to provide effective and timely assistance through programs cobbled together after the disaster has struck. Not surprisingly, these ad hoc programs can lead to inefficiencies, substantial delay and uncertainty, as well as real and perceived unfairness in aid distribution. Chubb believes that there is a better way; that a public–private partnership program can be implemented before the next pandemic that recognizes the differing needs of small and large businesses and will provide[35]:

- *Affordability and certainty for small businesses about the amount of financial support available if a pandemic shuts down the economy.*
- *Quick and efficient payment of a pre–determined sum to small businesses without the need to adjudicate individual claims.*
- *An incentive to keep people employed, rather than relying on unemployment relief.*
- *A market–oriented program for larger businesses intended to support and stimulate the private market for pandemic coverage.*
- *Insurance industry risk–sharing with the federal government, together with a better understanding of pandemic risk, risk mitigation and preparedness, increasing over time."*

These are key components of Chubb's proposed Pandemic Business Interruption Program. The Program has two elements: a program for small businesses that provides an immediate cash infusion when a pandemic is declared and a separate voluntary program for medium and large businesses with losses paid through the existing industry claims adjudication process. Both depend on the federal government assuming a substantial percentage of the risk, through direct U.S. Treasury funding to insurers for the small business program, and through a newly created government–run reinsurance entity for medium and large business losses[36].

For Small Businesses – Business Expense Insurance Program (BIP) -- the objective is to provide immediate cash to small businesses so that they can continue to pay employees and ongoing business expenses, thereby limiting economic disruption[36].

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[35] Pandemic Business Interruption Program (chubb.com)
[36] Legal blog from Lathrop GPM insurance recovery and counseling law practice for businesses: Lathrop GPM

For Medium and Large Businesses – Pandemic Re – the objective is to promote market–based pandemic risk mitigation for medium and large businesses with government support provided through Pandemic Re, a government reinsurance entity created for this purpose[37].

Chubb views the key advantages of its proposed plan as follows[37]:

- Recognizes and responds to different circumstances in a pandemic for small businesses, many facing immediate shut–down and limited financial resources versus medium and large businesses, which may be more capable of operating during a pandemic and have deeper financial resources.
- Commits insurance industry capital and provides opportunity for increased risk–sharing over time as direct and secondary markets develop, ultimately lessening government pandemic burden. The industry develops valuable risk management and risk mitigation knowledge and experience to encourage better societal behaviors related to pandemic risk.
- Leverages insurance industry claims expertise and existing payment capabilities to provide prompt payment to mitigate economic distress without requiring creation of complex government claims adjudication and payment process.
- Provides transparency, certainty of relief and a level playing field for businesses faced with pandemic loss, reducing economic disruption as businesses will have sufficient resources to maintain private sector payrolls and pay expenses.
- Encourages fiscal responsibility as a program with clearly defined mechanisms, triggers and benefits defined before a pandemic strikes, which will be more efficient and more equitable than ad hoc government relief programs created during a crisis.
- Pandemic Re provides opportunity for the government to participate in a reinsurance program at private market terms.

On May 18, 2020, the Insurance Information Institute (Triple-I) announced the launch of the Future of American Insurance & Reinsurance (FAIR) campaign. As communities reopen and restart, insurers will play a critical role in the process, continuing to provide financial protection for the millions of Americans who depend on them for indemnification from risks they rightfully insured. Yet the industry is threatened with growing calls to retroactively alter insurance policies, cover the economic cost of widespread closures, and adjust workers compensation criteria, among other new developments. FAIR will focus on ensuring the insurance industry is able to sustain its longstanding role as the country's backbone of economic growth and stability. "While the insurance industry has been doing its part to step up and support their communities in this time of crisis, pandemics are fundamentally uninsurable events. The federal government remains the only entity with the financial resources to help businesses recover from a systemic event of this magnitude. With the support of the public sector and the innovation of groups like insurers in the private sector, we can come together to work toward recovering from this catastrophe and build a more resilient future", said Triple-I CEO Sean Kevelighan[38]

According to the research conducted by the Geneva Association of insurance companies, commercial insurers have always sought to push the boundaries of insurability by developing innovative and viable approaches to new and emerging risks of major severity such as natural disasters or changes to liability regimes. For example, Alternative Risk Transfer (ART) solutions, introduced in the 1980s, are designed to better reflect individual risk characteristics, mitigate moral hazard (i.e. the risk of people behaving less

[37] Legal blog from Lathrop GPM insurance recovery and counseling law practice for businesses: Lathrop GPM
[38] Coronavirus news and updates | III

carefully once covered by insurance), offer (limited) cover for new exposures and expand capacity for large catastrophe risks (e.g. by tapping into the vast pool of institutional investment funds through Insurance-Linked Securities (ILS)). Despite the challenges of insuring pandemic business interruption, the paper notes that there is potential for future small-scale selected private market coverage by limiting the degree of risk transfer and the number of businesses covered[39].

The Geneva Association research also points out that world initiatives, in which governments join forces with the insurance market, have flourished, generating a range of different risk-sharing schemes that aim to address protection gaps for various large scale disasters. These schemes broadly have the same goal, which is to transform uninsured risk into insurance products that can be, at least partially, further transferred to global reinsurance markets in order to provide capital for recovery following a disaster. A large scale, detailed study of these schemes that is provided in the research is termed Protection Gap Entities (PGEs) that operate between the state and the market. The PGEs around the world emphasize primarily either removing risk from the market or redistributing risk across all policyholders as their primary means of risk-sharing[39].

The following are potential types of responses to pandemics—present and future—as they relate to business interruption, which are detailed in the paper[39]:

- Type 1: This type is aimed mainly at supporting businesses with immediate small-scale coverage during future waves of the current COVID-19 pandemic. The key risk to be addressed is disruptions in the return to work, in light of potential short-term and localized lockdown; that is, 'putting out the small fires' that may continue to occur as businesses reopen. This would be achieved by pooling risk between insurers and offering non-damage BI coverage for potential future waves of COVID-19.
- Type 2: Is designed as a post-event insurance product, aiming to provide businesses with an immediate cash injection and recovery support, paid for over the long-term and backed by a government credit risk guarantee. It relies on both government capacity and insurance industry commitment.
- Type 3: Is a large-scale, government-backed premium pool to reinsure pandemic-specific non-damage business interruption (NDBI) insurance cover. It relies on the government as a financial backstop to cover any claims but is largely insurance industry-led in its execution.
- Type 4: Takes a broader, multi-peril approach. It is designed for NDBIs as a result of any future systemic events, such as a cyber-event, or the systemic effects of climate change.
- Type 5: Includes focused government-backed solutions that partially and temporarily remove a specific risk from a business sector to the government balance sheet, rather than the entire risk for that particular sector. This is designed to resolve, temporarily, the lack of appetite from the private insurance market in offering insurance products to cover those losses.

[39] Public-Private Solutions to Pandemic Risk: Opportunities, challenges, trade-offs (genevaassociation.org)

Section 5: Impact of COVID-19 on Businesses, Insurers and Reinsurers: Magnitude of Losses and Future of Business Interruption Coverage

The closure of manufacturing plants, restaurants, retail establishments and other places of business to limit the spread of COVID-19 has resulted in significant business interruption losses. The vast majority of these losses are likely to be absorbed by the affected businesses as: (i) many businesses have not acquired coverage for business interruption losses (only about 30% of businesses in the US have acquired coverage for business interruption); and (ii) unless governments (or courts) intervene, few of the companies that have acquired business interruption coverage have coverage that is likely to respond to these types of losses[40].

Some insurance products have been developed to offer explicit coverage for business interruption losses suffered as a result of an infectious disease outbreak, either as a specialty stand-alone policy or as an endorsement to a policyholder's existing business interruption coverage. In 2018, for example, a specific coverage for financial losses due to outbreaks, epidemics or pandemics was made available although there has reportedly been almost no take-up. The Insurance Services Office in the United States developed two optional endorsements for commercial property policies applicable to business interruption losses as a result of business closures related to COVID-19 in February 2020, although it is too early to determine whether insurers will seek to offer that coverage. There are also a few commercial insurance policies that specifically include pandemics as a covered peril in some markets. In addition, some coverage has been developed for non-damage business interruption which is meant to respond to any interruption to business that does not involve physical damage to the insured premises or a building in proximity to the insured premises (which would include pandemics unless specifically excluded under the terms of the coverage). However, non-damage business interruption remains a specialty coverage with limited penetration[41].

Some policyholders may purchase contingent business interruption coverage which usually covers losses incurred by the policyholder as a result of a disruption at a supplier or customer (potentially named and often sub-limited). Contingent business interruption is often linked to the coverage provided to the policyholder for perils and property damage (i.e. if the property damage incurred by a supplier or customer would have been covered had it been incurred by the policyholder, then the contingent business interruption coverage is triggered) and therefore is subject to the same issues of whether contamination is covered by physical damage[42].

While it is difficult to assess the frequency of pandemics, the potential severity of losses is immense. The magnitude of business interruption losses that are likely to be incurred as a result of COVID-19 (whether by policyholders or their insurers) is much higher than the losses incurred as a result of any recent single catastrophe event. For example, in the United States, one estimate suggests that small businesses (businesses with fewer than 100 employees) alone face monthly costs of USD 255 billion - USD 431 billion as a result of business closures, including incidental expenses, payroll obligations and lost profits. By comparison, the Great East Japan Earthquake in 2011 (the largest economic loss from a single event since at least 1970) resulted in USD 234 billion in losses (in 2018 USD). The estimates suggest that providing comprehensive coverage for all business interruption losses for a pandemic of similar magnitude as COVID-19 would entail absorbing losses at much greater levels than any catastrophe event in the past and would require a significant increase in the amount of premiums collected to fund those losses[37]. Monthly business continuity losses of $1 trillion dollars, for example, are more than 200 times the $4.5 billion in monthly premium collected for all commercial property lines (fire, allied lines, and commercial multiple peril non-liability). Note that premiums for

[40] Responding to the COVID-19 and pandemic protection gap in insurance (oecd.org)
[41] Uninsurability-of-Pandemic-Risk-White-Paper-Hartwig-APCIA-FINAL-WORD.pdf (uscriskcenter.com)
[42] Initial-assessment-of-insurance-coverage-and-gaps-for-tackling-COVID-19-impacts.pdf (oecd.org)

business interruption coverage, which are not specifically reported, are only a fraction of this overall commercial property premium amount. Hence the true multiple is much larger[43].

The American Property Casualty Insurance Association (APCIA) estimates that one month's business continuity losses related to COVID-19 for all United States businesses (without regard to whether the business purchased business interruption coverage, as has been proposed in some states) totals approximately $1 trillion per month, which exceeds the current total property casualty industry capital and surplus of approximately $800 billion. The industry's surplus represents capital insurers are legally required to hold to ensure funds are available to pay current and future claims. Limiting this analysis to businesses with fewer than 100 employees, produces monthly business continuity losses of $255 billion to $431 billion per month—and $393 billion to $668 billion per month for businesses with fewer than 500 employees. Stated differently, the $800 billion capital and surplus that the industry has accumulated over the course of more than a century could be exhausted in a matter of weeks. Even if business continuity losses are limited to small businesses (i.e., those with fewer than 100 employees) that actually purchase insurance coverage for business interruption, estimated losses are in the range of $52 billion to $223 billion per month, implying the exhaustion of the industry's capital and surplus in as few as 3.6 months[44].

The latest concern for the insurance marketplace is the rejection by regulators of property-casualty insurer exclusions to clarify, once and for all, that communicable diseases (e.g. COVID-19) are not covered. Viral outbreaks and pandemics have always been and continue to be broadly uninsurable. Historically, viral and pandemic risk has never been broadly considered to be covered, even in the absence of an express exclusion. The introduction of exclusionary endorsements in the past for viruses, bacteria and other pathogens did not change the underlying policy intent but rather provided additional clarity to reduce attempts to use litigation to expand direct coverage to include an uninsurable exposure. Those efforts to contravene policy language and expand direct coverage where none is intended manifests today in the proliferation of COVID-19 related lawsuits. Reinsurance markets are similarly trying to react responsibly to the cost and uncertainty these lawsuits present by excluding the uninsurable risk. Reinsurance treaties are now including near-absolute communicable disease exclusions particularly as they relate to liability protection. That means primary insurers must file similar exclusions in order to maintain consistency between the coverage they offer and the reinsurance available to them. Today, many of those filings are not being approved. The rejection of primary company exclusions combined with the widespread adoption of such exclusions in reinsurance contracts threatens to compromise the relationship between insurers and reinsurers that has been so critical in maintaining stability in insurance markets for decades[45].

Given the recent experience with COVID-19, it is likely that insurers will be reluctant to provide broad coverage for business interruption in the near future (or at least not at a cost broadly accessible to commercial policyholders). Some reports suggest that insurers are reducing or eliminating any potential coverage for pandemic risk in property damage and business interruption policies and are considering applying various exclusions in other lines of business where some exposure is likely. There is also a high-level of uncertainty related to the frequency and severity of infectious disease outbreaks. While catastrophe models for pandemic risk have existed for a number years, these models are focused on morbidity and mortality, not the business interruption losses that would be addressed by a pandemic risk business interruption insurance program[42].

A group of US insurance associations (APCIA, the National Association of Mutual Insurance Companies (NAMIC) and the Independent Insurance Agents and Brokers of America (Big I)) have proposed the establishment of a Business Continuity Protection Program that would provide federal compensation for up to 80% of specific types of operating

[43] Uninsurability-of-Pandemic-Risk-White-Paper-Hartwig-APCIA-FINAL-WORD.pdf (uscriskcenter.com)
[44] Responding to the COVID-19 and pandemic protection gap in insurance (oecd.org)
[45] Microsoft Word - CD Exclusion White Paper v12c FINAL.docx (pciaa.net)

expenses (including payroll, employee benefits and other operating expenses) for up to three months following the declaration of an emergency. Businesses would need to purchase this protection in advance and would need to certify that: (a) the proceeds of the compensation will be used to retain employees and pay necessary operating expenses; and (b) that the business will implement all applicable federal guidance on health and safety measures during the health emergency. The protection could be acquired by any business incorporated in the United States on a voluntary basis. The private sector would not take on any of the future pandemic risk, and it would be completely backstopped by the U.S. federal government[46].

According to S&P Global Ratings, the top 20 global reinsurers reported about $12 billion in COVID-19 losses through June 2020. The current forecast is that this cohort will generate a combined ratio of 103%-108% in 2020 and 97%-101% in 2021, and a return on equity (ROE) of 0%-3% and 5%-8%, respectively[46]. Reinsurance rates increased significantly during the June 1, 2020 renewals as underwriters reacted to COVID-19 related losses. Higher prices were expected to continue throughout 2020 and into 2021. Meanwhile, reinsurers are inserting virus exclusions in reinsurance treaties amid disputes over insurance coverage[47].

Overall, standard business interruption policies are unlikely to cover COVID-19-related losses unless legislation is passed, or court rulings are handed down that effectively nullify or change policy definitions. Regardless of such coverage decisions, insurance carriers can expect to experience an increase in administrative expenses from responding to state inquiries or data calls as well as claim-related expenses as policyholders file an unprecedented number of claims and potential lawsuits[48].

COVID-19 could produce social inflation as businesses sue their insurers in an attempt to access their business income interruption coverage for losses relating to the pandemic. However, court closings may have a downward effect on social inflation as people may be more willing to settle than wait for a delayed trial[49].

[46] Responding to the COVID-19 and pandemic protection gap in insurance (oecd.org)
[47] Reinsurance rates jump as COVID-19 adds uncertainty to market | Business Insurance
[48] COVID-19 Impact to Property & Casualty Insurance | Deloitte US
[49] Coronavirus news and updates | III

Section 6: Future of Insuring a Pandemic

Currently, pandemics are excluded from most BI insurance policies because pandemics, by definition, impact many people or businesses over an extended continuous period of time. Generally, property/casualty insurance works by pooling risk, taking limited and randomly occurring events (fires, automobile accidents, windstorms) and distributing the associated expected costs over a large pool of policyholders. This risk distribution is facilitated by the reinsurance market, which spreads the risk over the global financial markets. When an event is potentially very widespread, perhaps affecting millions of policyholders for a continuous extended period on a global basis, the model of distributing costs over a larger pool does not work well. Also, a commercial insurance model does not work well for events like a pandemic when the potential cost is large, has no clear maximum, and occurs very infrequently. American Academy of Actuaries discussed this problem in greater detail in a recent letter to the Financial Services Committee[50].

In some cases where the private insurance market has been unable or unwilling to provide very large amounts of coverage for certain risks that are hard to estimate or might never have occurred before, the federal government has established programs to facilitate insuring against such perils (e.g., terrorist attack, nuclear power plant meltdown, and flood). These federal programs do not follow the private sector's insurance practices of determining exposure, spreading the potential cost over the insured population, and then collecting sufficient funds and maintaining sufficient assets to pay all claims when they arise. By putting a cap on how much risk the marketplace is expected to handle and then providing a federal backstop for the rare and unpredictable event that exceeds that cap, these federal programs facilitate a vibrant insurance market. While different government insurance programs have varying designs for government reimbursement, they do provide for recoupment by the U.S. Treasury[51].

The Pandemic Risk Reinsurance Program, as outlined in H.R. 7011 legislation, would cover business interruption policies written by participating insurers. Claims under such policies would be defined to also include event cancellation. Upon purchase of a policy from a participating insurer with a pandemic inclusion, a policyholder would pay a premium that represents the insurer's expected exposure to potential pandemic claims. When a declared pandemic generates $250 million in covered losses, the governmental role would be triggered. The government's share, 95% of losses above insurers' deductibles up to a total of $750 billion, would be funded from general funds of the U.S. Treasury. When claims occur, the policyholder would submit a claim to its insurer. The insurer would aggregate its claims to see whether these types of claims meet its aggregate deductible. When the deductible is met, the insurer would then submit the information claim by claim to the federal government for the federal government to process. The federal government would pay 95% of the amounts above each insurer's deductible. The legislation is not clear on whether the governmental funds are a reimbursement to the insurer when the insurer's deductible has been met or whether these claims are paid directly to the insured businesses. In addition, the legislation provides that the participating insurer is liable only for its deductible, but the 5% that the federal government does not pay above its deductible appears to fall to the insurer to pay. Thus, insurers would be responsible for losses in their deductible layer plus 5% of losses in excess of their deductible layer (with no limit) plus potentially a portion of the remaining 95% of losses in excess of their deductible layer, to the extent these are not paid for or reimbursed by the federal government, for example when the total losses are less than $250 million[50].

In response to the tragedies of September 11th, 2001, the U.S. Congress passed the Terrorism Risk Insurance Act, or "TRIA," which helped provide sufficient terrorism insurance to U.S. policyholders by mandating the offering of terrorism insurance coverage while providing a backstop for losses payable through funds provided by the U.S.

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[50] Pandemic_Risk_HR_7011.pdf (actuary.org)
[51] Coronavirus news and updates | III

Secretary of Treasury (the "Treasury"). In the wake of COVID-19, there is increasing momentum for the passage of a Pandemic Risk Insurance Act, or "PRIA," as well[52].

There are a number of practical and legislative differences between TRIA and PRIA that could impact PRIA's reach and success: as an initial matter, terrorism risks and pandemic risks are inherently different. While both sets of risks present the prospect of catastrophic damage and immense insurance liabilities, terrorism risks are likely to be greatest in global city centers. While large metropolitan areas also are likely to be most impacted by pandemics, COVID-19 has clearly demonstrated that disease does not respect state lines or stay confined to discrete neighborhoods, with nearly every state imposing some level of business closures as a result of the pandemic. As such, because PRIA will likely contemplate that pandemic insurance be provided on terms that "do not differ materially" from other components of business interruption insurance coverage, the insurance and reinsurance markets will need to collaborate closely to determine what the premium price points should be. From a drafting standpoint, there are a number of important distinctions between TRIA and the PRIA Discussion Draft. First, the PRIA Discussion Draft is a voluntary program whereby participating insurers would be required to pay reinsurance premiums to the Treasury for participation; by contrast, TRIA is a mandatory program. Moreover, it also remains to be seen how broad PRIA's "make available" requirement will extend if passed. TRIA requires that each insurer "shall make available, in all of its property and casualty insurance policies, coverage for insured losses…" By contrast, the PRIA Discussion Draft is worded slightly differently and requires that each insurer shall "make available, in all of its business interruption insurance policies, coverage for insured losses…" (Emphasis added). Therefore, on its face, TRIA is significantly broader and mandates that terrorism coverage be provided in connection with any commercial property and casualty insurance policy. In contrast, PRIA may only require coverage for "covered public health emergencies" in connection with business interruption insurance policies, and only then for voluntarily-participating insurers. While certain components of PRIA have been met with general optimism, efforts to enforce retroactive coverage by insurance companies of COVID-19 claims (particularly when in-force insurance policies contain communicable disease exclusions) has been met with a significantly different tone from the insurance community[53].

Insuring against business continuity losses from pandemics poses a particular set of challenges to insurers that the industry argues collectively render the risk uninsurable in private insurance markets on a large scale. Potential losses can easily exceed the industry's capital, surplus and premium resources, posing a systemic risk to the industry and the overall economy. Because virtually all businesses may sustain losses simultaneously and continuously over the span of many months, the ability to spread risk—a function essential to the smooth operation of insurance markets—is severely compromised. Frequency and severity of losses cannot be precisely modeled because of a lack of historical data, creating an insurmountable obstacle to accurate pricing. Further, business income-related pandemic losses are correlated with both financial market losses and other insurance losses, so insurers cannot mitigate pandemic-related business continuity losses through diversification (stated differently, pandemic risk cannot be spread, shared or diversified across policyholders). Consequently, it is unlikely that private insurance markets will be able to offer affordable, widely available commercial insurance products that insure against business continuity risks from pandemics. Comprehensive government programs designed to directly address large scale business continuity losses from pandemic are necessary to address this risk prospectively and could, over time, potentially encourage the innovation of limited specialized pandemic coverages by private insurers and reinsurers[52].

The insurability of risk traditionally rests upon six criteria listed below[54]:

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[52] Pandemic Risk Insurance Act and the Future of Business Interruption Insurance - Insurance & Reinsurance (insurereinsure.com)
[53] Pandemic_Risk_HR_7011.pdf (actuary.org)
[54] Uninsurability-of-Pandemic-Risk-White-Paper-Hartwig-APCIA-FINAL-WORD.pdf (uscriskcenter.com)

1. A risk must consist of a large number of exposure units so that the losses of the few can be distributed across the entire population of policyholders.
2. Losses must be accidental/random and unintentional in nature.
3. Losses must be determinable and measurable, enabling accurate and timely adjustment.
4. Losses cannot be exceedingly catastrophic or financially ruinous to the risk pool as a whole.
5. The probability of loss must be calculable, necessary for the proper modeling and pricing of risk.
6. The premium charged by insurers to transfer the risk of loss must be economically affordable.

The inability of a risk to meet one or more of these criteria reduces or eliminates its insurability. Pandemic risk violates all six criteria[55].

[55] Uninsurability-of-Pandemic-Risk-White-Paper-Hartwig-APCIA-FINAL-WORD.pdf (uscriskcenter.com)

Conclusion

The COVID-19 pandemic has had and continues to have a significant impact on Business Interruption Insurance. There is a great deal of ongoing disagreement related to the covered events and whether insurers should be required to pay businesses for the losses caused by the virus. Numerous court cases have been and continue to be filed, with majority of wins so far being on the side of the insurer.

There is also a great deal of pending legislation, both at the state and at the federal level, with the attempt to mitigate current and future impact of the COVID-19 and any other potential future pandemic losses that could have a similar impact on businesses as well as the insurance industry. This includes any specific legislation geared towards refining the Business Interruption coverage language itself as well as any broader programs that would include government assistance initiatives for the insurers to be able to pay out on claims incurred due to the outbreak of a virus.

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With roots dating back to 1889, the Society of Actuaries (SOA) is the world's largest actuarial professional organization with more than 31,000 members. Through research and education, the SOA's mission is to advance actuarial knowledge and to enhance the ability of actuaries to provide expert advice and relevant solutions for financial, business and societal challenges. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of risk.

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