JOINT MEMO
TO
MEMBERS OF THE TEXAS LEGISLATURE

Property Casualty Responses to COVID-19; Business Interruption Coverage & Other Insurance Issues

From: The Texas and National Property/Casualty Insurance Trade Associations—Insurance Council of Texas (ICT); American Property Casualty Insurance Association (APCIA); National Association of Mutual Insurance Companies (NAMIC); Reinsurance Association of American (RAA); the Association of Fire and Casualty Companies of Texas (AFACT); and the Texas Coalition of Affordable Insurance Solutions (TCAIS).

Date: May 4, 2020

This memo supplements a March 27, 2020 joint trade memo to members of the House Insurance Committee and the Senate Business & Commerce Committee to assist them in understanding some of the basics of business interruption insurance coverage, exclusions and provide updates on recent developments. You can review and access this memo at the ICT website at: ictcovid19.org/legislativeregulatorylitigation . We hope this memo will assist you and your staff in better understanding business interruption insurance issues being discussed, industry responses to COVID-19, and other important insurance issues. A viable solvent insurance industry is vital to the economy of any state or nation.

We are in the midst of an unprecedented crisis and the insurance industry is aware of the concerns and needs of individuals and businesses due to the magnitude of this crisis. Events are changing rapidly, on almost a daily basis.

Industry Responses to COVID-19. We want to assure you that insurers are open and working as an essential business, which has been recognized in virtually all orders issued at federal and local levels. and handling claims unrelated to COVID-19, such as auto, home, and other business losses. Among the industry's responses during this pandemic:

- actively working with customers in need (by instituting moratoriums on cancellations and non-renewals, providing premium payment grace periods, etc.);
- implementing an estimated $10.5 Billion[1] in refunds and credits for personal auto insurance;
- implementing mid-term audits for certain types of commercial policies, which may reduce premiums based on payroll or sales; maintaining employment for thousands of employees;
- implementing innovative solutions to maintain operations while also respecting social distancing;

[1] This is a nationwide estimate furnished by the Insurance Information Institute through regular updates on its website at http://www.iii.org.

- contributing and pledging over $220 Million to charitable organizations to assist in national and local organizations fighting the pandemic on the frontlines;[2] and
- proactively educating clients and media outlets about preparing for the upcoming storm season.

Beyond the COVID-19 pandemic, insurers are preparing for more severe natural and man-made catastrophes including hail storms, tornadoes, hurricanes, wildfires, and cyber-attacks. These covered catastrophes continue to increase in terms of overall loss costs.

Insurers are also bracing for a possible next wave of claims including increased claims involving: workers' compensation; retailers who use delivery services; and lawsuits that may trigger duties to defend and indemnity under liability coverages such as comprehensive general liability (CGL); employer liability claims; directors and officers claims; and cyber claims.

Business Interruption Coverage. Our March 27, 2020 memo discussed the basic standards of coverage in the ISO form, which is widely used on most policies. As discussed, the language of a specific policy will control and the language in any specific insured's policy will control whether COVID-19 interruptions are covered. A basic overview of this coverage follows:

<u>What Is Business Interruption Insurance Coverage and How Does it Work?</u>

- Business interruption insurance covers financial losses (e.g., continuing operating expenses, lost income) when a business cannot function because of physical damage to a commercial property due to a covered loss (e.g., a fire in a restaurant kitchen, damage to a building from a hurricane).
- Only about 40% of commercial property insureds purchase this coverage, and it is purchased by an even smaller percentage (30%) of small businesses.
- Most policies contain a virus/bacteria exclusion. Closure by civil authorities does not itself trigger coverage. The closure must be the result of a covered loss and not excluded.
- Examples of payments for covered business interruption losses include payments made by TWIA after Hurricane Ike and Hurricane Harvey.

<u>Is Business Interruption Coverage Available to Pay for COVID-19 Losses?</u>

- For most commercial policies, the answer is <u>no</u>. There are important financial and practical reasons explained in more detail below. Basically, there is no coverage for pandemic events of this nature widely available in the marketplace today unless specifically endorsed in a policy.
- This is true not only for insurers licensed in Texas but true for all insurers world-wide. Every insurer must purchase reinsurance from a world-wide market to protect itself against catastrophic losses and ensure that it can pay claims for such losses.

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[2] See, Insurance Information Institute Economic Updates, http://www.iii.org and information posted by the Insurance Council of Texas at https://www.insurancecouncil.org/ and https://ictcovid19.org/ .

- To recover under business interruption coverage, losses must be related to physical damage inflicted upon the insured's property. There is no physical damage predicate in the context of the COVID-19 pandemic. Recent publications from plaintiff's lawyers active in pursuing business interruption claims acknowledge if there was an argument of physical damage from COVID-19, it can be remediated with a few days and the typical coverage form requires a business to be closed for more than 72 hours before there can be recovery.[3] As noted in media reports, buildings and other locations can be cleaned and re-entered. The typical coverage form requires a business to be closed for more than 72 hours before there can be recovery. In addition, during this COVID-19 stay-at-home period, numerous restaurants are open for take-out and to go orders but limited by civil authorities for seating.
- As reflected above, since at least 2005, the vast majority of commercial policies with a business interruption component contain an explicit exclusion for any losses caused by any virus. COVID-19 is the virus responsible for the current pandemic and the related business closures, and the exclusion precludes coverage.

<u>Why Is There an Exclusion for Losses Caused by COVID-19?</u>

- Pandemics are essentially uninsurable under standard business policies, and the losses associated with a pandemic are beyond what the existing insurance mechanism can afford to cover.[4]
- Insurance policies contain exclusions for losses caused by events like war, nuclear and radiation accidents, and pandemics because the potential losses are so extreme and widespread that providing such coverage would threaten insurer solvency and force companies to charge premiums that would be cost-prohibitive.
- Exclusions for extreme perils of this nature are commonplace, and the policy terms are contained in filings routinely submitted to state insurance departments.
- Insurers also could not reinsure these pandemic risks because reinsurance is not available for such coverage.

Unfortunately, much of the media and other commentary on business interruption claims related to COVID-19 has inappropriately treated all insurance policies as though they are identical. Policyholders have a wide array of different policies they can purchase. The basic policy used for most commercial risks that has been purchased is an ISO Businessowners Policy (BOP) with standard terms and exclusions as discussed above. A few policyholders may have purchased other types of coverages or variations from the standard ISO form

[3] See, Harvard Medical School resource page at https://www.health.harvard.edu/diseases-and-conditions/covid-19-basics. Citing a study found that the COVID-19 coronavirus can survive up to four hours on copper, up to 24 hours on cardboard, and up to two to three days on plastic and stainless steel. The researchers also found that this virus can hang as droplets in the air for up to three hours before they fall. But most often they will fall more quickly.

[4] Even if coverage is afforded in special policies, coverage specifically for a pandemic may be limited with coverage limitations, definitions, and other limitations such as sublimits and time limits.

At a recent webinar sponsored by the Insurance Law Section of the Texas State Bar webinar, an example of a specialty policy that provides coverage was shown by the presenters.[5] The following is an example:

INTERRUPTION BY DISEASE/CRIME/INFESTATION/SANITATION

This Policy covers the Actual Loss Sustained and Extra Expense incurred by the Insured due to cancellation of or inability to accept bookings and/or reservations for accommodations or rentals and/or a cessation of diminution of trade due to a loss of potential customers, as a direct result of:

1. *The occurrence at an Insured location of murder, suicide, rape, attempted rape, armed robbery, malicious activities, contagious and/or infectious disease, food or drink poisoning, vermin, pests or defective sanitation;*
2. *The outbreak of a contagious and/or infectious disease, the discovery of which causes restrictions on the use of an Insured location on the order of a competent local authority.*

The period of liability under this policy as respects this extension of coverage shall not exceed 30 days from the date of such an occurrence.

We would urge a careful detailed analysis under individual circumstances before drawing broad conclusions on whether all claims or a particular claim are covered. Not all policyholders purchase business interruption coverage so coverage issues should not arise when a policyholder has elected not to purchase this coverage.

Misinformation that insurers are not paying for covered claims for business interruption or never pay business interruption claims do not help and may offer false hope to businesses that are struggling through the crisis. Companies pay business interruption claims that are covered under a particular policy or for covered perils. [6]

Other developments relating to business interruption coverage include:

Litigation. Lawsuits have been filed in state courts such Louisiana and Florida and more are anticipated. The suit in Louisiana was on a surplus lines policy issued through Lloyds of London. Suits seeking coverage for business-interruption losses have also been filed in various federal courts across the United States, including a suit in the Western District Court of Texas (Austin Division).[7] These suits are being coordinated through firms in Chicago, California, and Pennsylvania. It has been reported that two groups of plaintiffs — one in Philadelphia, the other

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[5] Vincent Morgan and Stephen M. Melendi, "**COVID-19:** Can Insurance Inoculate Against Damage From the Virus?", Webinar, Insurance Law Section of the State Bar of Texas, April 22, 2020.

[6] Recent examples include business interruption losses cause by windstorms such as Hurricane Harvey and Hurricane Ike. TWIA is one example—where had over 378 BI claims with payment after Hurricane Ike, which resulted in payments by TWIA in excess of $11 Million. After Hurricane Harvey, TWIA had approximately 193 claims with paid losses in excess of $10.8 Million. Private insurers also paid BI claims after a covered loss caused by hurricanes.

[7] *Lonesome Dove LLC v. FFIC Ins. Company*, No. 1:20-cv-00425, In the US District Court, Western Division of Texas, Austin Division.

in Chicago — are asking federal courts to consolidate lawsuits filed by businesses that are seeking coverage for business-interruption losses caused by coronavirus stay-home orders. [8]

Several state insurance commissioners have issued public statements on whether lawsuits will result in business interruption coverage. Kansas, Maryland, Mississippi, West Virginia, North Carolina and the District of Columbia have posted notices that losses from coronavirus shutdowns usually won't be covered, either because of specific exclusions or because virus is not specifically listed as a covered peril.[9] Commissioners in Georgia, Louisiana, Mississippi, and Missouri have either made posts or issued letters casting doubt on whether existing policies provide coverage.[10]

Legislation. In some jurisdictions, legislation has been filed to revise insurance contracts and compel insurers to retroactively pay for losses under business interruption coverage. New Jersey was the first state to propose a bill that would mandate insurers cover COVID-19-related losses under their business interruption policies, and the insurance industry was quick to express its concern. New York and Pennsylvania have recently proposed their own COVID-19 business interruption bills, bringing the total to seven states that have introduced legislation like this. Similar to New Jersey, New York and Pennsylvania is legislation that has been floated in Louisiana, Ohio, Massachusetts and South Carolina. None of these proposed bills have yet passed.[11]

Financial Impact if Business Interruption Coverage for COVID-19 Losses Was Required Retroactively or Prospectively Would Be Catastrophic for the Property-Casualty Industry.

Insurers do not collect premiums for excluded risks of loss and forcing insurance companies to pay for losses that were not accounted for and supported by premium will jeopardize the solvency of the insurance system.

The magnitude of these losses could be enormous and would threaten the financial health of many insurers, quickly send some domestic companies into insolvency, and destabilize an otherwise healthy economic sector. The insurance industry will be needed to support economic activity and help fuel our economic rebound when the restrictions are lifted, but it will not be positioned to do so if measures like this are enacted into law.

Such proposals would require insurers to utilize the premiums collected for other specified risks and set aside to pay claims, and the outlays this would mandate will almost certainly exceed the amount of premium collected for all commercial property insurance.

Estimates have varied among different groups but the math from any estimate is clear: **mandating BI payouts for pandemics would create financial instability by severely eroding the industry surplus -- a pool that is intended to cover damages resulting from insured losses including natural catastrophes like fires, tornadoes, and hurricanes, among other commonly**

[8] https://www.claimsjournal.com/news/national/2020/04/23/296699.htm
[9] https://www.claimsjournal.com/news/national/2020/04/27/296741.htm
[10] *Id.*
[11] https://www.claimsjournal.com/news/national/2020/04/16/296600.htm

insured risks.[12] Under various assumptions and scenarios being considered, retroactive legislation could have a material adverse impact on the surplus of property casualty industry.

National Associations of Insurance Commissioners and the National Council of Insurance Legislators Warn Against Retroactive Mandates on BI Coverage for COVID-19.

The National Association of Insurance Commissioners (NAIC) – which is comprised of the regulators responsible for ensuring the solvency of the industry and protecting consumers – has cautioned against and expressed opposition to such proposals. They have said requiring the payment of claims that were not covered "would create substantial solvency risks for the sector, significantly undermine the ability of insurers to pay other types of claims, and potentially exacerbate the negative financial and economic impacts the country is currently experiencing."

A complete copy of their statement issued in March 2020 is attached as Appendix A.

The National Council of Insurance Legislators (NCOIL) has stated that such proposals are unconstitutional and "inadvisable for policy and economic reasons." NCOIL has also noted that requiring payment for such losses would destabilize insurance companies, "render them unable to pay claims for which they did accept the risk," and "jeopardize the solvency of any number of insurers."

We hope the information in this memo will assist you. We look forward to working with you during the next session of the Legislature. If you have questions or need additional information, please contact us below:

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[12] Insurance Information Institute, Fact Sheet updated 4/30/2020 at https://www.iii.org/article/the-true-cost-of-rewriting-business-income-interruption-policies; APCIA has estimated even higher potential monthly losses if BI was mandated. Both III and APCIA estimates show potential massive decreases in surplus of p/c insurers that could impact all lines of business.

APPENDIX A
Statement of the National Association of Insurance Commissioners
March 25, 2020

State insurance regulators are committed to working at the state and federal level to help mitigate the devastating economic impacts of the coronavirus (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.

We thank Congress and the Administration for acting quickly to give states greater flexibility to protect consumers and deal with ever-changing market dynamics, and we look forward to continuing that partnership as issues arise. However, as Congress considers further legislative proposals to address the devastating impacts of the COVID-19 pandemic, we would caution against and oppose proposals that would require insurers to retroactively pay unfunded COVID-19 business interruption claims that insurance policies do not currently cover.

Business interruption policies were generally not designed or priced to provide coverage against communicable diseases, such as COVID-19 and therefore include exclusions for that risk. Insurance works well and remains affordable when a relatively small number of claims are spread across a broader group, and therefore it is not typically well suited for a global pandemic where virtually every policyholder suffers significant losses at the same time for an extended period. While the U.S. insurance sector remains strong, if insurance companies are required to cover such claims, such an action would create substantial solvency risks for the sector, significantly undermine the ability of insurers to pay other types of claims, and potentially exacerbate the negative financial and economic impacts the country is currently experiencing.

Moving forward, if Congress believes that the business interruption insurance sector can play a vital role in addressing the policy challenges of future pandemics, we stand ready to work with Congress on such solutions. However, swift action by Congress to directly address the needs of citizens and our economy is the most effective and expedient means to addressing the devastating impact of COVID-19.