Pandemic Business Interruption Insurance Coverage: Insights from WSB Survey of Insurance Experts

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NAIC National Association of Insurance Commissioners
The Center for Insurance Policy and Research
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EXECUTIVE SUMMARY

As businesses across the country (and the globe) have been forced to shut down to contain the spread of COVID-19, many have turned to their insurance policies for indemnification of their losses through business interruption (BI) insurance coverage. However, only about 40% of small businesses in the U.S. purchase BI coverage, and for many policies in place, pandemics are excluded or not explicitly covered[1].

As a consequence of this significant coverage gap, there have been state and federal legislative proposals to either: i) retroactively provide coverage regardless of policy existing policy language; or ii) create a government-backed pandemic insurance program to provide BI coverage for pandemics moving forward.

The Wisconsin School of Business (WSB) Insurance Experts Panel explores the extent to which insurance experts agree or disagree on major public policy issues affecting the insurance industry. We turned to the more than 50 insurance experts on the WSB Insurance Experts Panel to obtain their insights on this significant BI coverage issue.

Overall, we find that:

1. An overwhelming majority of the experts surveyed believe that the legislative proposals requiring business interruption insurers to cover claims stemming from Covid-19 related shutdowns, even if the insurance policies exclude pandemic-related losses, threaten the solvency of the insurance industry.

2. In terms of how BI insurance for pandemics should be covered in the future:
   - The majority of experts believe that the private market will have a difficult time efficiently supplying business interruption insurance coverage for pandemics given the systemic, correlated, and non-diversifiable nature of the pandemic peril.

   - Many of the experts felt that only the federal government can provide coverage for correlated risks because its ability to spread the cost intertemporally through taxation, long-run borrowing, and deficit financing. But whether provided by only the federal government or the private market, the pricing and affordability of coverage were indicated to be issues for both.

   - A majority of the experts believe that the private market can supply BI coverage for pandemics with an effective federal partnership. Some experts questioned whether the Terrorism Risk Insurance Program (TRIP) is a good model for pandemic insurance, given the inherent differences in the pandemic and terrorism perils.

Below we provide an overview of the survey methodology employed as well as some further detail on the survey responses to each BI related question, including highlighting key themes that emerged from the text responses provided. We encourage you to review the full results published here – https://explore.wsb.wisc.edu/risk-and-insurance-guidance

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[1] *https://www.reuters.com/article/health-coronavirus-insurance-pandemics/u-s-insurers-want-taxpayers-to-back-pandemic-coverage-for-businesses-idUSL2N2CF270*

SURVEY METHODOLOGY AND SUMMARY OF RESULTS DESCRIPTION

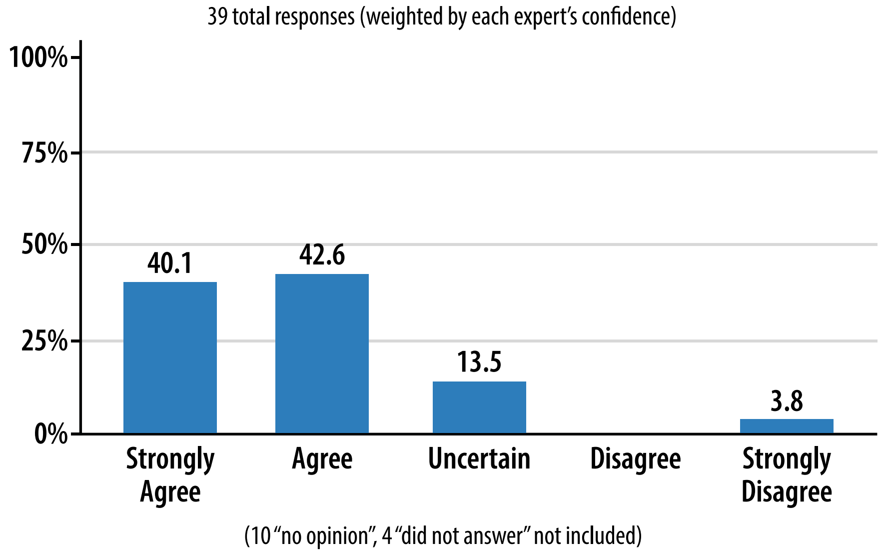
We asked respondents to provide their opinions on a number of questions using Qualtrics, a web-based survey tool to conduct survey research. The questions are structured for agree or disagree responses along a scale of strongly agree to strongly disagree. In some instances, a panelist may neither agree nor disagree with a statement. When an expert feels that the evidence on the exact claim at hand is ambiguous, the panelists may vote "uncertain". When an expert believes the topic is far removed from their expertise, the panelists may vote "no opinion". Respondents also provide the confidence that they have in their opinion on a 1 to 10 scale (with 1 being low confidence and 10 being high). Finally, respondents are able to provide context to their responses through brief written comments. Comments, however, are not required.

In the summary below, we provide the confidence weighted responses, excluding any "no opinion" responses. We also identify the number of experts that responded to each question, ranging from 39 to 46 of the 53 experts surveyed. We then use the comments from the experts to identify the key themes that emerge, summarizing them by response categories of agree and strongly agree; disagree and strongly disagree; and uncertain.

This study represents the opinions of the author(s) and is the product of professional research. It is not intended to represent the position or opinions of the National Association of Insurance Commissioners (NAIC) or its members, nor is it the official position of any NAIC staff members. Any errors are the responsibility of the author(s).

SUMMARY OF BI QUESTION SURVEY RESULTS AND ACCOMPANYING TEXT

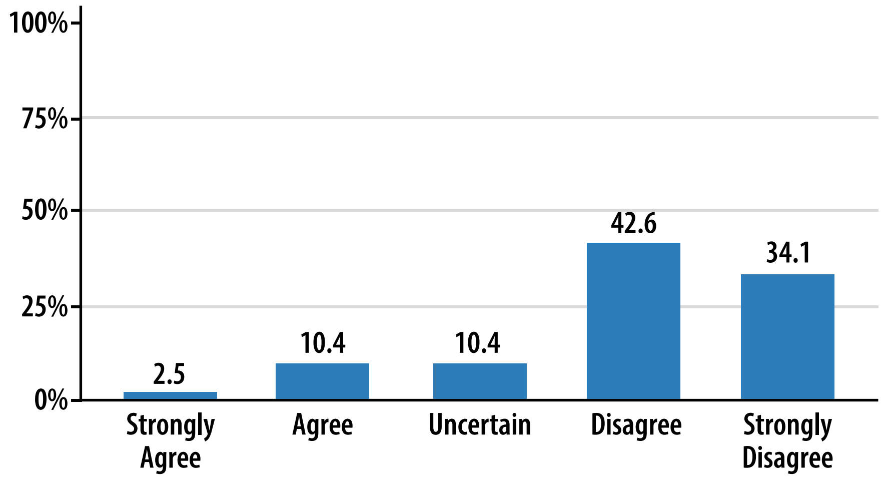
SURVEY QUESTION #1: Many states, and the federal government, are proposing legislation to require business interruption insurers to cover claims stemming from Covid-19 related shutdowns, even if the insurance policies exclude pandemic-related losses. Without government assistance, the resulting business interruption losses will likely exceed the total policyholder surplus (equity capital) of these business interruption insurers?



- **83% Agree or Strongly Agree – Key themes included:**
  - The industry has a total surplus of approximately $800 billion. One month of lockdown yields an annual GDP loss around 5%. Insurers are totally unable to cover that. An estimate of losses and surplus indicates insurer surplus would cover about 3 months of business interruption losses.
  - Simultaneously, the states adopting such legislation will destroy the BI market and possibly the commercial property insurance market. It would create substantial uncertainty and costs in the marketplace, and potentially undermine other coverage exclusions that protect insurers against correlated losses. It could bankrupt a potentially large segment of the industry, which also supplies a good deal of insurance for other purposes.
  - Premium was never charged for this risk and to cover it retroactively would violate every notion of contract law and insurance principles .
- **4% Disagree or Strongly Disagree**
- **13% Uncertain – Key themes included:**
  - The losses could indeed be catastrophic, though the industry's ability to withstand would depend on how many states enact the legislation and the nature of the funding mechanisms used.
  - It depends on the insurer and their exposure to business interruption business.

SURVEY QUESTION #2: Business Interruption Insurance Covering Pandemic risks can be efficiently supplied by the private market?

46 total responses (weighted by each expert's confidence)

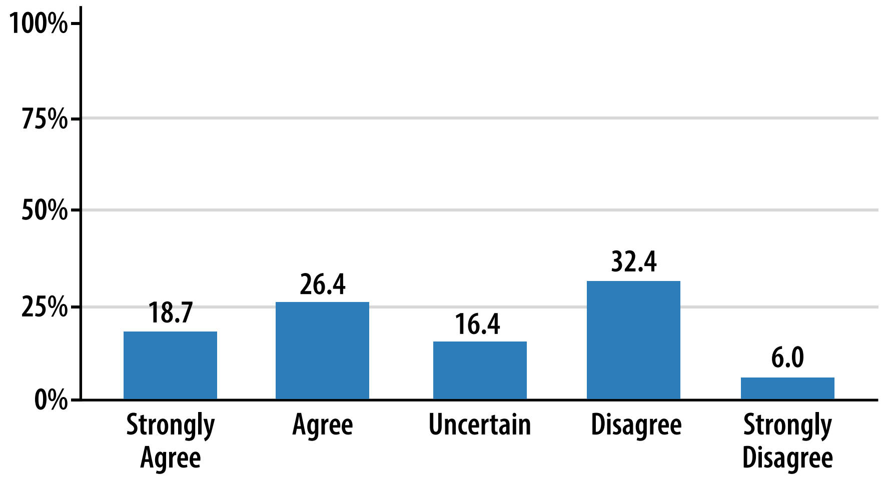


(3 "no opinion", 4 "did not answer" not included)

- **13% Agree or Strongly Agree – Key themes included:**
  - Insurers will need to include a large risk premium to avoid insolvency concerns.
  - Losses may be primarily caused by business closure due to a civil authority order, and this may already be covered by existing commercial policies.
  - Risk not subject to adverse selection or moral hazard
  - Existing recent example – the University of Illinois's business school purchased an insurance contract over its Chinese applications.
- **77% Disagree or Strongly Disagree – Key themes included:**
  - Cannot pool the risk as it is systemic/aggregate, correlated, and a non-diversifiable risk coupled with negative asset market shocks
  - Difficult to predict and price.
  - For prolonged or severe pandemic while supply might be possible, pricing would not be affordable; capital costs would limit demand at market prices.
  - Due to government & firm action, losses may not be unintentional or accidental. Difficult to draft policy language that limits risk; need to distinguish coverage for pandemic risks and coverage for risks of government actions to address pandemics.
- **10% Uncertain – Key themes included:**
  - Smaller scale events possible to cover, but likely result in relatively limited insurance penetration in circumstances where consumers are not being forced to buy coverage. Is this efficient?
  - Would require government supported reinsurance.

SURVEY QUESTION #3: Only the federal government can provide business interruption insurance for pandemic risks?

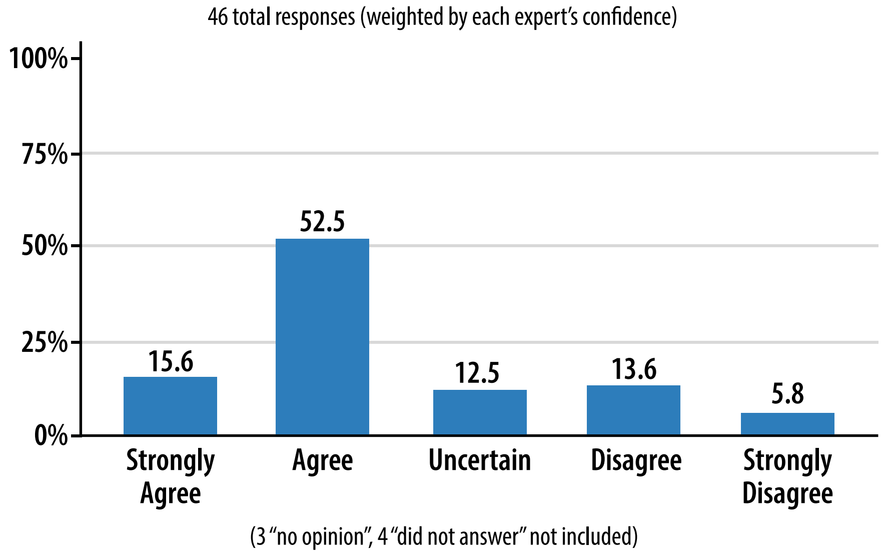
45 total responses (weighted by each expert's confidence)



(4 "no opinion", 4 "did not answer" not included)

- **45% Agree or Strongly Agree – Key themes included:**
  - Perfect case for social insurance – government can provide coverage for correlated risk and spread the cost among all through taxation, long-run borrowing, deficit financing; externalities are substantial in a pandemic environment that require a public intervention.
  - If insurers were to cover it, they would need to reserve for it, and this would lead to extremely high premiums, and consequently fewer businesses buying the coverage.
  - States could also play some role in providing business interruption insurance (e.g., state-level residual market facilities), although they are more constrained in their budgeting.
- **39% Disagree or Strongly Disagree – Key themes included:**
  - Private insurers can provide BI insurance, if priced properly. Capacity exists for most any kind of coverage. It is all a matter of the cost; need to be able to set contract terms.
  - The government's provision of insurance has a number of offsetting flaws, including an inability to price it rationally as evidenced by other federal programs.
  - Just because the private provision of coverage is difficult does not mean that this can only be provided by the federal government, a public and private partnership could be possible – e.g., a reinsurance facility with the federal government or involved as a backstop.
  - Question whether even a federal program would be feasible; the federal government has already set a precedent for massive bailouts that will create an indelible moral hazard on this market.
- **16% Uncertain – Key themes included:**
  - Only" is probably too strong, but the Feds seem like the best option for substantial coverage.
  - There could be an effective hybrid with the private sector. Global capital markets could potentially provide part of the insurance in some way.

SURVEY QUESTION #4: Private-market business interruption insurance could cover pandemic risks if there were an effective federal partnership? (For example, under the Terrorism Risk Insurance Program the private market is the primary insurer but the federal government provides reinsurance protection.)



- **68% Agree or Strongly Agree – Key themes included:**
  - Needs: federal government backstop (appropriately priced); regulatory environment that permits securitization of the risk; acceptable definition of pandemic including triggers as well as rational and consistent behavior from public policy makers – strong protection against government interference; carefully define terms and to limit coverage.
  - Let the private market work at the primary level (more accurate pricing depending on the business/location/etc...) and the federal government gets involved at the higher levels; an opportunity here to use the efficiency of the private insurance industry to create a platform for macro-economic support to businesses during pandemic (and potentially other) widespread shut downs.
  - It is not obvious that TRIP is a good analogy to pandemic insurance. TRIP allows private insurers to cover modest-sized or localized terrorism risk while providing a federal backstop against catastrophic losses.
  - There is little that an individual company can do to mitigate their risk from pandemic shutdowns. As such, insurance price cannot encourage risk mitigation. With that backdrop, it would make more sense for this system to simply involve federal transfers to cover losses caused by the perils covered by this arrangement (i.e., pandemic state of emergency) perhaps with modest "buy-in" costs for the companies to help partially fund the system.
- **19% Disagree or Strongly Disagree – Key themes included:**
  - What is the gain from the involvement of the private insurance industry?
  - Pandemic losses are an order of magnitude larger than terrorist losses, which are mostly diversifiable. The private insurance market could be part of the delivery mechanism, but not the funding mechanism – the amount of risk that private insurers could bear would be so small as to be almost trivial. If the private market cannot cover the smallest loss, it does not make sense for them to participate on the risk.
  - For a TRIA like proposal to work, pandemic coverage must be mandatory for all commercial business policies. That will make prices higher and perhaps dissuade people from purchasing insurance.
  - Would create an immediate, large liability on the P/C insurance industry's balance sheet. P/C insurers are simply not the appropriate vehicle for delivering pandemic aid to businesses. However, the full arsenal of federal and state policy tools is.
- **13% Uncertain – Key themes included:**
  - The analogy to the "Terrorism Risk Insurance Program" does not really apply here. With terrorism, there is some risk of correlated payouts that the government needs to protect against. With pandemics, all payouts are almost by definition highly correlated
  - Catastrophic potential appears to be much greater for a pandemic than for terrorism.
  - A hybrid program where the federal government provides most of the payouts, but contracts with private insurers to design policies subject to certain constraints.