Testimony of the American Property Casualty Insurance Association

Federal Response to the Economic Impact of the COVID-19 Pandemic on Small Businesses in New York State

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Kristina Baldwin
Vice President, State Government Relations
American Property Casualty Insurance Association
kristina.baldwin@apci.org
518-443-2220 (office); 518-322-1923 (cell)

Alison Cooper
Vice President, State Government Relations
American Property Casualty Insurance Association
alison.cooper@apci.org
518-462-1695 (office); 518-791-0314 (cell)

The American Property Casualty Insurance Association (APCIA) is a national trade association representing nearly 60 percent of the U.S. property casualty insurance market. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers. APCIA represents the broadest cross-section of home, auto, and business insurers of any national trade association. APCIA members represent all sizes, structures, and regions, which protect families, communities, and businesses in the U.S. and across the globe. APCIA appreciates the opportunity to provide this written testimony for this hearing on the federal response to the economic impact of the COVID-19 pandemic on small businesses in New York State. We would be happy to respond to any follow up inquiries that may arise upon review of this testimony.

The coronavirus public health emergency has had a devastating impact on businesses, employees and their families in New York and across the country. Property casualty insurance companies are working hard to respond to policy and claims inquiries from policyholders across the state and stand ready to pay all legitimate claims for covered losses. In addition, property casualty insurers have been providing premium payment grace periods to consumers and small businesses and a number of insurers have provided auto insurance premium credits in light of reduced driving during this period.

While property casualty insurers stand behind the promises which they have made to pay all legitimate claims for covered losses, insurers cannot pay claims which are not covered under the policy and for which premium was not collected. One area of insurance which has been the subject of much discussion during the COVID-19 pandemic is business interruption insurance. Currently, most business interruption (BI) insurance policies require that physical damage must have occurred in order to trigger coverage for such losses and specifically exclude viruses or bacteria. APCIA opposes any proposal which would turn property insurance on its head by extending coverage and requiring the payment of claims that were not contemplated when the relevant policy contracts were issued, thus putting the solvency and the very foundation of insurance as legal contracts at significant risk.

To be clear, our industry understands the urgency of helping businesses and individuals recover. The answer for business continuity protection, however, must come from the federal government. Congress and the Administration are actively working on current and prospective federal relief programs for business continuity protection. Their goal is to provide hundreds of billions of dollars in additional targeted relief to impaired businesses as well as to establish a prospective program for business continuity funding before a potential COVID-19 recurrence this Fall or in future years. The proposals for providing immediate relief with the most support are those increasing funding for the current programs such as the Paycheck Protection Program ("PPP") and bipartisan discussions of a COVID-19 Business and Employee Continuity and Recovery Fund (the "Recovery Fund" which would provide streamlined federal grants to the most impaired businesses willing to retain or rehire most of their employees). Proposals being considered for prospective business continuity include legislation based on the Terrorism Risk Insurance Act for pandemic risks ("PRIA") and a direct federal government protection program.

Viral Outbreaks are Effectively Uninsurable Risks

Widespread viral outbreaks are generally uninsured because they are effectively uninsurable risks. Pandemics are extremely challenging to model. There have been 7 pandemics in the last 19 years each causing billions of dollars in economic losses, but none on the scale of COVID-19. We simply do not know enough about the potential frequency or severity of future pandemics, or even a recurrence of COVID-19, which could happen before enough premiums could be collected to pay for the next loss.

The Chief Economist for the International Monetary Fund estimates that the coronavirus will cause $9 trillion in economic losses globally.[i] While insurers have provided some individual one-off policies for viral risk, particularly for event cancellation coverage, insurers cannot provide protection against economic downturns that can hit the entire nation at one time. There have been seven pandemics in the last 18 years causing multi-billion-dollar losses, five of which caused damages nearly as high or exceeding Hurricane Katrina (which was the most expensive insured loss event in U.S. history).[ii] One-month's current U.S. business continuity losses for COVID-19 are estimated to exceed the entire U.S. property casualty surplus[iii] and would far exceed the surplus of the fraction of insurers who provide business interruption insurance. Viral risks are potentially too widespread, severe, and continuous over time to underwrite.

Losses from viral outbreaks also correlate with other catastrophic losses. COVID-19's impact on U.S. property casualty insurers include expected (non-business interruption) insured losses of $40-80 billion and an $87 billion property casualty surplus loss from market declines. In other words, COVID-19 related losses for insurers are already expected to far exceed insured losses for Hurricane Katrina and 9/11 combined, before any consideration of state and federal proposals for retroactive coverage. Insurer revenues correlate directly with changes in the U.S. GDP and are expected to drop significantly in the second quarter. The National Association of Insurance Commissioners explained:

> *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.* [iv]

Business interruption insurers, which represent only a portion of the commercial insurance industry, simply do not have the balance sheets to take on additional pandemic risk that is highly correlated with other simultaneous catastrophic economic and insured losses. Business continuity losses for just small businesses up to 500 employees are running roughly 100 times the monthly premiums for all commercial property insurance.

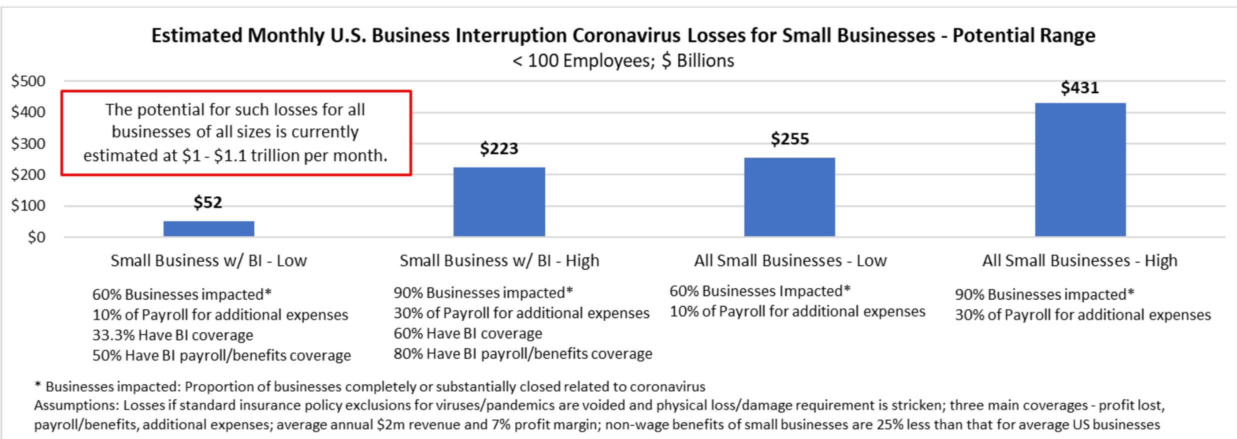
While a small number of insurers have made some limited viral coverage available, consumer take-up rates were exceedingly low for a very simple reason – actuarially-priced viral coverage is extremely expensive and would need to be extensively subsidized by the government to encourage an adequate number of businesses to purchase the product and an adequate spread of risk. APCIA estimates that coverage for viral outbreaks would add tens of billions of dollars in annual premium costs for a business interruption coverage that a majority of small and mid-sized businesses already find too expensive to buy. Viral outbreak risks are effectively uninsurable because insurers do not have the balance sheet to provide a meaningful supply of coverage, while consumers have been unwilling to provide meaningful demand at market rates.

Business Continuity Losses

APCIA currently estimates that COVID-19 losses suffered by American small businesses (fewer than 100 employees) are in the range of $52-$223 billion per month for the segment of the businesses that have some insurance coverage for business interruption (BI) insurance. However, the business interruption insurance policies purchased by such businesses typically do not cover losses resulting from viruses or pandemics. The estimate for the impact on *all* small businesses with fewer than 100 employees (those with or without BI insurance coverage) is $255-$431 billion per month.[v]

The current total property casualty industry capital and surplus is approximately $800 billion. Thus, were the business losses described above in the current crisis allowed to fall on the U.S. property casualty insurance industry, those losses would entirely wipe out the industry's capital and surplus for all lines of business in a matter of a few months, making the segment financially unviable. We emphasize that this only accounts for losses of *small* businesses with fewer than 100 employees, not of *all* businesses.

The potential for BI-type coverage losses for *all* businesses of all sizes (not just small businesses), with or without BI coverage, is currently estimated at $1-$1.1 trillion per month. *Thus, total business interruption losses in just a single month would more than wipe out the entire capital and surplus of the U.S. property and casualty industry.*



To further illustrate the problem, it may also be helpful to consider how much premium insurers are collecting on commercial property coverages compared to the potential total business interruption losses from COVID-19. Total 2019 U.S. direct written premium for commercial property (Fire, Allied Lines, and Commercial Multiple Peril Non-Liability) which includes BI insurance, among many other coverages, has average monthly premium of around $4.5 billion per month. The expected monthly small business loss scenarios presented above (from lowest estimate of $52 billion to highest estimate of $431 billion) are in the general range of 10 to 100 times the $4.5 billion average monthly premiums for all commercial property. While premiums for business interruption insurance specially are not currently available, they represent only a fraction of the overall commercial property insurance premium and would be even more greatly dwarfed by the current business continuity losses.

A.M. Best recently affirmed the concerns of the NAIC about retroactive business interruption coverage and the potential "devastating impact" on the property casualty insurance industry:

Business interruption coverage is typically triggered by events causing direct physical loss or damage. To date, federal and state bills under consideration seek to retroactively require insurers to cover the loss of use and occupancy of physical premises, as well as the business interruption-related costs, regardless of policy language. These bills, which to date mainly are focused on smaller businesses, would sanction an interpretation that runs contrary to a policy's original wording and require coverage that was never intended when the policy was underwritten and priced. AM Best believes that forcing insurers to pay for COVID-19-related business interruption claims, despite any specific policy exclusions, could threaten many insurers' solvency and reap disastrous consequences for the U.S. property/casualty insurance industry. [vi]

The International Association of Insurance Supervisors (IAIS) underscored their similar concerns:

[T]he IAIS cautions against initiatives seeking to require insurers to retroactively cover Covid-19 related losses, such as business interruption, that are specifically excluded in existing insurance contracts. In such cases, the costs of claims against losses have not been built into the premiums that policyholders have paid for their insurance. Requiring insurers to cover such claims could create material solvency risks and significantly undermine the ability of insurers to pay other types of claims. Such initiatives could ultimately threaten policyholder protection and financial stability, further aggravating the financial and economic impacts of Covid-19. [vii]

Recent New York legislative proposals would apply to small businesses defined as 250 or fewer employees (rather than 100 as in the scenarios described above). Therefore, APCIA calculated potential losses for New York small businesses under that definition as well. For businesses with 250 or fewer employees (with or without BI coverage), APCIA has estimated the potential for BI-type losses for New York businesses to be in the range of <u>$25-$42B per month</u>. For comparison, the entire annual property casualty direct written commercial lines premium in New York for 2019 was slightly over $27 billion. Thus, if a retroactive BI coverage mandate were enacted in New York, the cost of providing coverage retroactively for merely one month could equal or exceed the total entire premium collected for the entire year. It should be noted additionally that retroactive coverage would most likely end up in lengthy and expensive litigation that would not benefit any parties but could significantly destabilize individual commercial insurers and cause a significant contraction of the overall insurance marketplace.

A.M. Best expressed its concerns that:

[T]he impact of any such legislation on the P/C insurance industry would be catastrophic, almost certainly compromising the financial ability of insurers to meet their existing financial obligations related to insurance coverage provided to individuals, families, motorists, state, and local governments, and businesses. This would have a profoundly negative impact on all consumers and businesses that rely on the insurance market for protection and could have a destabilizing impact on the P/C insurance industry as well as the broader economy. [viii]

<u>Challenges of State-by-State Solutions</u>

Should states seek to address pandemic business continuity issues, it is likely that the most exposed states with the densest urban populations would be at the highest risk and thus pay the most for viral outbreak coverage. State programs would be unlikely to have access to enough funding to subsidize the billions of dollars necessary (for the larger states) to provide coverage. Insurers would not be willing to participate in programs that would force uninsurable risks onto their balance sheets. And most businesses that were impaired in the current crisis will not be able or willing anytime soon to make very significant additional payments even for partly subsidized coverage. The federal Coronavirus Aid, Relief, and Economic Security (CARES) Act is expected to cost at least $1.8 trillion in assistance. States simply do not have the ability to print money and – even when combined with the financial assets of insurers doing business in the state – cannot come close to responding to the magnitude of the closure losses. Even if states set up public risk facilities for pandemic exposures, they would not have the capacity to spread the risk beyond their state's borders, even with post-event financing, based on the sizes of losses in the current pandemic.

Federal Developments

In addition to proposals to increase the funding of the CARES Act, including PPP, Congress is open to considering new proposals for immediate relief and is actively working on prospective federal solutions to provide business continuity relief and future protection.

Recovery Fund Proposals: A group of over 110 business trade associations representing businesses from 30 different business sectors that employ roughly 45% of the pre-COVID-19 workforce is advocating for legislation to create a Recovery Fund modeled after a more streamlined version of the 9/11 Victim's Compensation Fund. APCIA and the major property casualty insurance trades are supporting these efforts and we are working to have this proposal included in the next major Congressional COVID-19 relief legislation.

There are active discussions in the House and Senate around two draft bills each of which would seek to offset operating expenses (but not profits) for participating businesses, provide for prompt distribution of payments, and be led by a Special Administrator. Both proposals are expansive in defining eligible entities but diverge to some extent in scope and in the ability to prioritize grants. To date, no member of congress has formally agreed to introduce the proposals but several members in both parties and on both sides of the Capitol are considering doing so.

Prospective Proposals. Looking beyond this current pandemic, there have been preliminary discussions regarding a federally backstopped program to ensure future pandemic insurance claims are covered. There are multiple pre-existing models for structuring federally backed pandemic coverage. Representative Maloney (D-NY) is in the process of developing the Pandemic Risk Insurance Act (PRIA) of 2020, to create a system of shared public and private compensation for business interruption losses resulting from future pandemics or public health emergencies. Analogous to the Terrorism Risk Insurance Act (TRIA) in many respects, PRIA would create a federal backstop for insurance claims related to a pandemic or epidemic. Unlike TRIA, however, participation for insurers would be voluntary, but those electing to participate would be required to offer BI coverage for pandemics. Furthermore, participating insurers would be required to purchase reinsurance from the federal government at actuarially sound rates. Even if rates for the primary coverage were subsidized (not a feature of current PRIA proposals), this would certainly lead to insurance rates for businesses that are unaffordable.

Viral outbreaks are an uninsurable risk. Therefore, it is unlikely most insurers would be willing to participate in a program that required offering an uninsurable coverage on all their business interruption policies. Participation in PRIA would likely be limited to a very small number of captive insurers of very large commercial risks offering coverage solely to their parent company. Beyond those very large companies creating captive insurers to take advantage of a PRIA backstop, few consumers would be willing to purchase viral outbreak coverage at the required actuarial rates. APCIA is concerned that this approach will create unfulfilled promises without achieving the objective of providing businesses with the protection they need. PRIA has not yet been formally introduced or proposed and may serve only to initiate conversations about potential solutions.

APCIA's current principles for a business continuity protection program are that:

- Widespread viral outbreaks are not insurable risks
- The potential magnitude of viral outbreaks demands a federal solution
- Federal protection must be simple to administer; capable of providing immediate relief; subsidized and available to all businesses to encourage adequate take-up and reduce moral hazards
- Federal protection must provide certainty for businesses and insurers
- Viral risk is uninsurable, but insurers could service a prospective federal business continuity program

APCIA is currently working on a federal program to operationalize these principles and we hope that an equitable and workable prospective program will be developed that will ensure business continuity protection going forward.

On the state level, one potential area of focus in this regard might be on ensuring that small businesses are aware of business continuity programs and options so that policyholders are able to plan and make informed decisions going forward. APCIA would be happy to assist the legislature in any efforts to further policyholder awareness of the potential available coverage options.

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[i] International Monetary Fund (IMF) Chief Economist Gita Gopinath, "The Great Lockdown: Worst Economic Downturn Since the Great Depression", April 14, 2020.

[ii] APCIA using published reports, including IMF, World Bank, Learnbonds.com; APCIA adjustment to 2020 USD.

[iii] APCIA estimates based on publicly available data sources, Bureau of Labor Statistics, Insurance Services Offices estimates (Verisk Analytics, Inc.), Houston Chronicle, and S&P Global Market Intelligence.

[iv] https://content.naic.org/article/statement_naic_statement_congressional_action_relating_covid_19.htm, March 25, 2020.

[v] See also A.M. Best estimate of $294 billion per month for small business (100 employees or fewer) monthly continuity losses: http://news.ambest.com/presscontent.aspx?refnum=29325&altsrc=9, May 5, 2020.

[vi] Ibid.

[vii] https://www.iaisweb.org/page/news/press-releases//file/89860/iais-media-release-financial-stability-and-policyholder-protection, May 7, 2020.

[viii] Best's Commentary, "Legislation to Nullify BI Exclusions Poses Existential Threat to P/C Insurers", May 5, 2020.