FAIR

Future of American Insurance & Reinsurance

# Business Interruption Insurance And COVID-19

Fall 2020

# Executive Summary

- **Business interruption (BI) insurance covers a business's operating expenses in the event of a loss caused by physical damage (for example, damage caused by a hurricane).**
- **At the outset of the COVID-19 pandemic, thousands of businesses across the country were forced to close due to government-mandated lockdown measures. Some of these businesses attempted to collect BI payouts from their insurers, even though most BI contracts explicitly state that coverage extends only to losses caused by physical damage.**
- **Misled by trial attorneys, some of these businesses have attempted to take insurers to court, arguing that COVID-19 can be classified as physical damage**. Almost all of these cases have so far been decided in favor of insurers.
- **Since pandemic risks were not priced into BI policies when they were issued, any court-ordered or statutorily-mandated reinterpretation of BI contracts would likely bankrupt the insurance industry within a matter of months.** Forcing insurers to pay claims for uncovered pandemic risks would also jeopardize the industry's ability to pay existing covered claims, such as auto accidents or fire damage, and potentially trigger broader systemic damage to other financial institutions.
- **Only the federal government has the financial wherewithal to cover pandemic risks. A pandemic recovery solution must feature the federal government as the primary provider of relief.**

# How Does Insurance Work?

- Property and Casualty insurance (P/C) helps **protect individuals and their property**.
- The basic function of P/C insurance is to **transfer risk among a broader pool of individuals**. The aim of P/C insurance is to reduce financial uncertainty and make accidental loss manageable.
- This risk transfer is achieved by substituting payment of a small, known fee—an **insurance premium**—to a common risk holder (an insurance company) in exchange for the assumption of the risk and a promise to pay in the event of such a loss.

**Types of P/C insurance:**

- Auto insurance
- Homeowners/rental insurance
- Commercial property
- Workers compensation insurance
- Pet insurance
- BI insurance

**Examples of P/C insurers*:**

Allstate®

ZURICH

Nationwide

CHUBB®

**Key facts:**

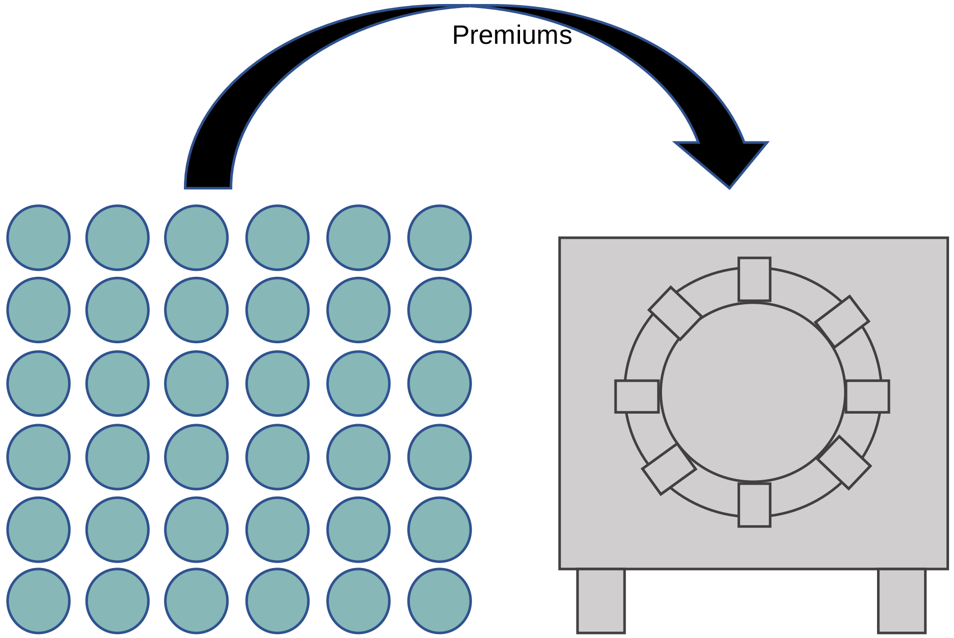
- Insurance carriers and related activities contributed nearly $630 billion, or 2.9 percent, to the U.S. GDP in 2019
- P/C insurers paid out $49.5 billion in property losses related to catastrophes in 2018
- 2.8 million people employed by US insurance industry in 2019

Sources and more information: https://www.iii.org/fact-statistic/facts-statistics-industry-overview

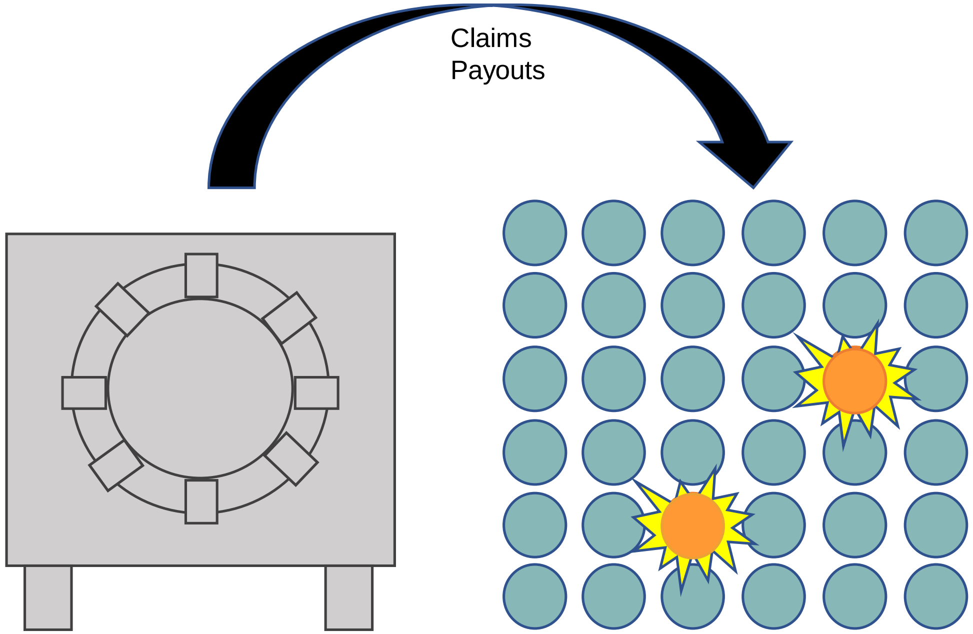
* FAIR and Triple-I are supported by insurance carriers, including these

# Risk Pooling Is The Foundational Concept That Makes Insurance Possible

- Insurers underwrite their policies and charge premiums based on modeled risk.
- Over time, the profits from policies form an extra cushion for tough times – **surplus.**




- Claims, such as car accidents, can be paid out without jeopardizing the surplus because they are **carefully underwritten** and because **risk is pooled** across insureds.



# Business Interruption Insurance Is A Type Of Product That Helps Businesses Recover From Closures Related To Physical Damage

- Business interruption insurance (BI) helps businesses recover when property has been physically damaged by a variety of events (fires, floods, riots, power outage, etc.) that prevent operations from running at normal capacity. It does not cover losses from airborne diseases such as the common cold, flu, or COVID-19.
- BI can help with operating expenses during the period it takes the business to return to normal. It covers lost net income (based on financial records), mortgage, rent and lease payments, loan payments, taxes, and employee payroll.

**Example: The Point Skate Shop (Dallas), June 2020**


Riots cause damage to storefront, resulting in loss of property and temporary store closure

Owner files insurance claim

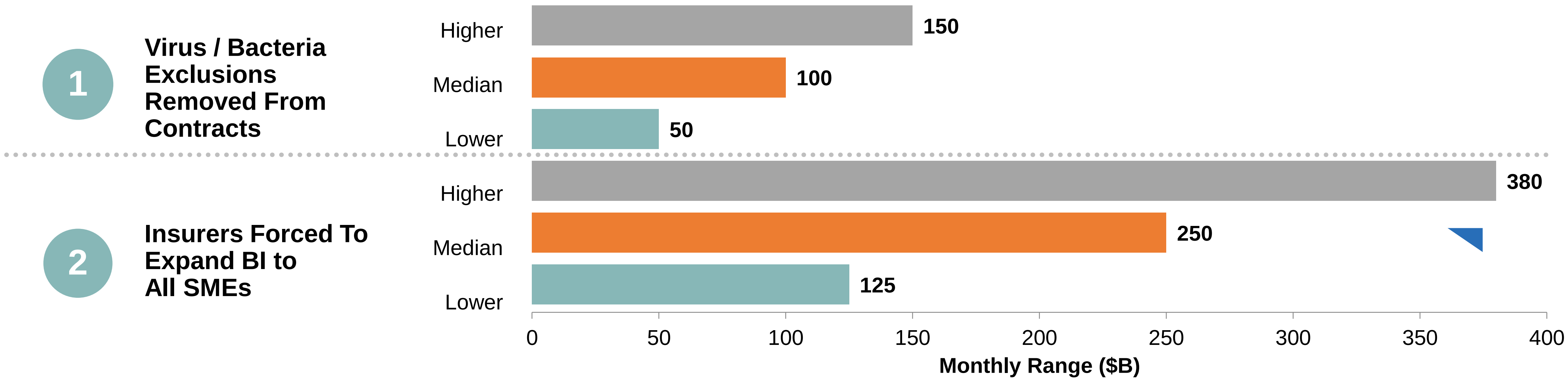
Insurance pays for cost of property damage (property insurance) and income lost as a result of closure (BI)

Source: CBS11 DFW

# Forcing Insurers To Pay For Pandemic Losses Would Likely Bankrupt The Industry, Putting All Claims At Risk

- The majority of BI contracts contain an exclusion for viruses and virtually all contracts specify that an interruption must be the result of physical damage in order to warrant an insurance payout.
- Pandemic risks are not priced into existing insurance policies; the corresponding premiums were never taken in.
- Efforts to either remove the virus exclusion retroactively or reinterpret COVID-19 as a form of physical damage would quickly erode the industry surplus, and likely bankrupt insurers.

## Estimate Of Monthly Industry Surplus Loss, By Scenario ($Billions):




Source: Insurance Information Institute: https://www.iii.org/article/the-true-cost-of-rewriting-business-income-interruption-policies

# Proposals To Retroactively Rewrite Or Reinterpret BI Contracts To Cover Pandemics Have Been Met With Strong Opposition

## Public Opinion

July polling commissioned by the industry and conducted by CivicScience found:

- **Only 16%** of Americans believe insurance companies should bear the responsibility for helping businesses during this unprecedented time.
- **A majority of Americans** believe the federal government should bear the financial responsibility for helping businesses stay afloat during the pandemic.
- **Just 8%** of Americans say trial lawyers' lawsuits against insurers is the best path for businesses to secure financial relief.

## Policymaker Opinions

Cross-partisan support for maintaining the integrity of insurance contracts:

- "The cost of underwriting these pandemics would be massive for insurers—nearly $400 billion per month—which would make such coverage extremely, and likely prohibitively, costly for small business owners."
  – **Fmr. Sen. Ben Nelson** (D-NE)
- "Forcing insurers to cover a risk where clear exclusions are in place would, in my mind, threaten not only the entire insurance industry but [also] insurance policy holders."
  – **Rep. John Joyce** (R-PA)

## Legal Opinions

Of the dozens of lawsuits across the country, almost all have been decided in favor of insurers:

- 10 of 11 rulings decided in favor of insurers as of September 17
- 'While there is no doubt that the COVID-19 crisis severely affected Plaintiffs' businesses, [insurer] cannot be held liable to pay business interruption insurance on these claims as there was no direct physical loss, and even if there were direct physical loss, the Virus Exclusion applies to bar Plaintiffs' claims" – **Senior United States District Judge David Alan Ezra**

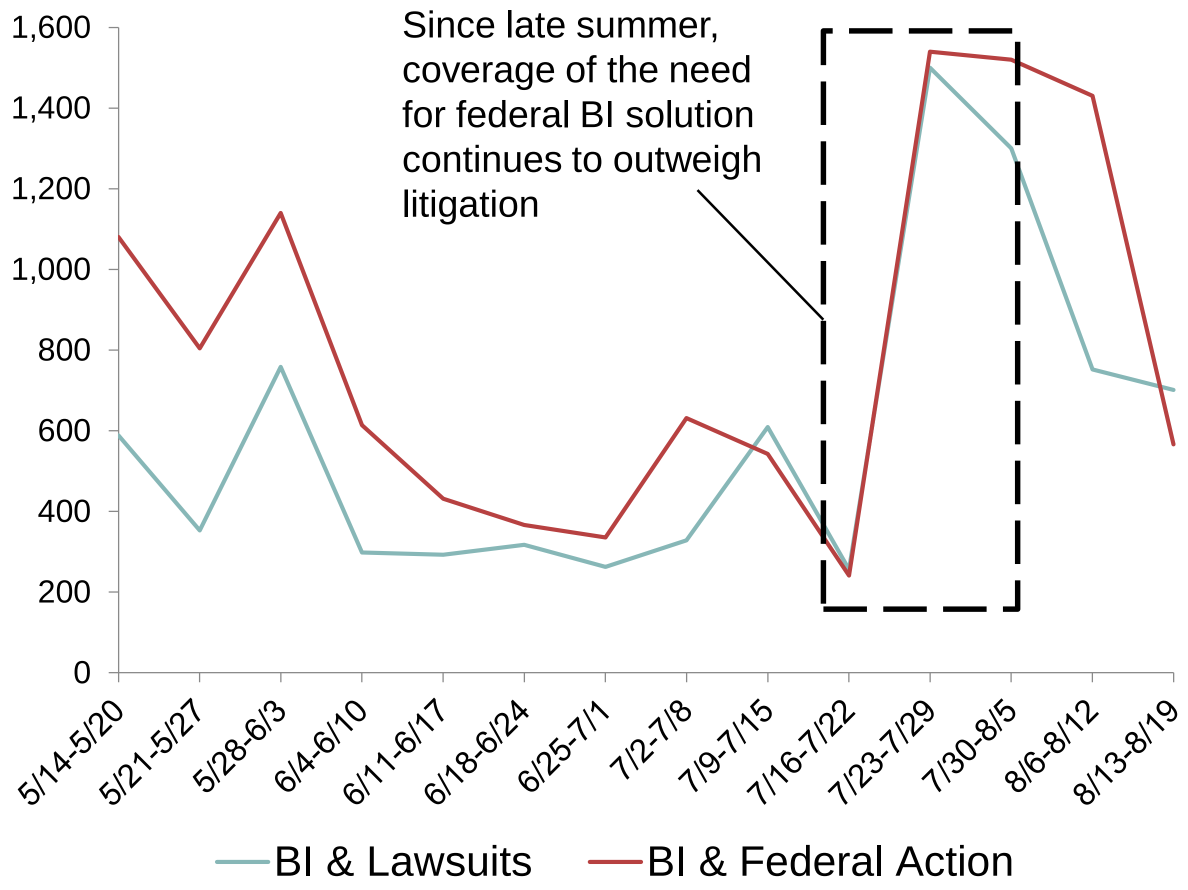
Source: fairinsure.org

# Rather Than Litigating The Issue In Courts For Years, Stakeholders Should Come Together To Design A Federal Response In The Near Term

Insurers and policymakers are putting forth a variety of potential federally-backed pandemic recovery solutions. To be financially feasible, such solutions must:

- Maintain the federal government as a primary provider of relief, reflecting the reality that pandemic risks are not privately insurable.
- Provide widely accessible relief payments to businesses in a fast and efficient manner once a pandemic is declared by the federal government, with minimal chance of abuse.
- Protect businesses from losses, and incentivize businesses to retain employees, without jeopardizing existing insurer commitments.

## Media Coverage Reflects Interest In Seeking A Federal Solution




SOURCE: FAIR Media Analysis, Meltwater

# Recap: FAQs

**What is Business Interruption insurance?**

- Business interruption insurance (BI) is a voluntary add-on to a business insurance policy, both of which help businesses recover when they have been physically damaged.

**Why do insurers argue they should not pay BI claims for COVID-19-related interruption?**

- Most BI policies specify that a covered claim must be caused by physical damage, and even further, most standard policies explicitly exclude coverage for viruses.

**If BI doesn't cover business interruption caused by a virus, then what does it cover?**

- Not all policies are identical, but coverage generally includes loss of business income caused by physical damage. For example, insurers have recently paid out millions of dollars in claims after business closures as a result of damage caused by rioting.

**Why does standard business interruption coverage not cover losses caused by pandemics?**

- Insurance works by pooling risk, which does not work when it comes to pandemic risks because all businesses close simultaneously. If insurers were forced to cover pandemic risks retroactively, the industry would be bankrupt within a matter of months.

**What is the solution to the pandemics and BI issue?**

- A federal solution is required: only the federal government is financially capable of covering pandemic risks.