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# Feasibility Questions About Government-Sponsored Insurance for Business Interruption Losses from Pandemics

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## Introduction

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Currently, there are at least two formal proposals to establish such a program.

and continuing normal operations expenses incurred, including payroll." The coverage grant states:

> 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 direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss.

The Causes of Loss – Broad Form (CP 10 20 10 12) provides named perils coverage for the familiar perils of fire, lightning, explosion, etc.; pathogens of any type are not among these perils. The Causes of Loss – Special Form (CP 10 30 09 17), or perhaps an earlier version, or some insurer's own proprietary version, is open perils coverage. For this coverage, policyholder lawyers assert there is the potential for coverage based on the exclusions, or lack of exclusions, specific

Policyholders also contend the stay-at-home orders, and related orders to close some businesses, trigger the civil authority coverage of these policies. This coverage, too, depends on property damage by a covered peril.

Whether a virus that can be wiped clean from the surface of personal property—as business firms now do frequently during the day to help assure customers of cleanliness and thus safety to operate a business—causes permanent alteration and contamination to constitute property damage is the question for the courts to resolve, and is beyond this paper to address.

## Terrorism Risk Insurance Act

TRIA was enacted in 2002 in response to reinsurers' unwillingness to provide coverage for terrorist events following the 9/11 terrorist attacks.[4] This, in turn, prompted primary insurers to exclude coverage for terrorism in their policies. The program essentially provides a federal reinsurance backstop for private insurers who provide coverage for property damage arising from a terrorist attack. The program comes into effect when an act of terrorism is certified by the secretary of the U.S. Department of Treasury (Treasury) that the act falls under the definition of "terrorism" under TRIA and triggers an event dollar threshold.

All insurers offering commercial lines covered under TRIA are required to offer terrorism coverage, but a firm is not required to buy it. Most commercial lines are covered under TRIA with a number of exclusions, including commercial auto and insurers to impose and remit additional premium surcharges for amounts paid by it for losses above the aggregate industry retention level.[6]

## Pandemic Risk Insurance Act

The current draft of PRIA has a number of provisions similar to TRIA, but also contains some important differences. Like TRIA, PRIA would be triggered by a declaration by the federal government of a specific calamity. In this case, the triggering event would be a “public health emergency” for an outbreak of an

## Insurance Contract Concerns

One category is insurance contract coverage concerns that go to what the insurance covers. First, what would constitute a covered loss is ambiguous.[9] If a business could only file a claim for losses when forced to completely shut down, this could be relatively straightforward for an insurer to determine. However, the bill requires only a declaration of a public health emergency by the secretary of HHS to trigger coverage, which is not the same as ordering businesses closed. This matters because quarantines and stay-at-home orders are issued by states and municipalities (Swendiman and Jones, 2009: 8–9). These two different jurisdictional triggers need to be connected. Even using public health emergency and state/local orders leaves a gap to the civil authority coverage in existing BI insurance because existing BI insurance requires damage to nearby property which creates a dangerous condition or requires unimpeded access to that damaged other property (typically within one mile of the damaged property but this distance can be altered by endorsement), (ISO Form, CP 00 30 10 12). Individual policies issued to policyholders may, of course, have different conditions for coverage. Therefore, this proposed bill's trigger of a public health emergency does not alone or together with a stay-at-home order fit into, let alone initiate, civil authority coverage under current BI insurance.

Second, the draft bill assumes a pandemic-caused loss is the same as the perils covered by typical BI insurance.[10] That is not the case. There is no obvious reason this new insurance could not create a specific pandemic (viral) cause of loss, subject to their being an income loss, but the bill is ambiguous or misdirected in either assuming or requiring that public health emergencies are part of, or should be part of, all BI policies. A properly crafted bill would create a separate cause of loss for pandemic-caused losses only, in line with terrorism as a separate cause of loss that triggers coverage under TRIA-backed insurance policies.

Third, the draft bill assumes that BI insurance now covers payroll expenses, thus providing income not only to the business for its own net profit but also the income for the workers.[11] That is not how BI insurance works. The choice to cover payroll is entirely discretionary for a business when it purchases a BI insurance

9. In one section, it defines BI insurance as "commercial lines of property and casualty insurance coverage provided or made available for losses resulting from periods of suspended business operations, whether provided under broader coverage for property losses or separately." However, in another section, participating insurers would be required to "make available business interruption insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than public health emergencies."

10. "The term 'insured loss' means any loss resulting from a covered public health emergency that is covered by primary or excess business interruption insurance issued by a participating insurer …"

11. "Make available business interruption insurance coverage for insured losses that does not differ materially from the terms, conditions, amounts, limits, deductibles, or self-insured retentions and other coverage grants, limitations, and exclusions applicable to losses arising from events other than public health emergencies."

policy (see, for example, Robinson, 2018).[12] If the draft bill intends that pandemic-caused losses provide income to workers, beyond income to management, then it must specify this requirement. Otherwise, payroll expenses would not be covered, and the resulting unemployed workers would be immediately bumped off to apply for unemployment insurance. If the bill's goal is (in part) to provide income to workers, then it must correct this gaping misassumption about what BI insurance covers.

A fourth issue goes to the "prohibition on duplicative compensation" in the bill, that reduces the "Federal share of compensation for insured losses under the Program … by the amount of compensation provided by the Federal Government to any person under any other Federal program for those insured losses." This is sensible. However, insureds will demand prompt payment by the insurers, and if the insured business can later seek other federal compensation, the burden should be on the federal government to offset that. This

employed to reduce more current rates for other lines, is a regulatory problem not addressed in this bill.

property insurance in place. This study also found that “younger and smaller firms

Table 1
Statistics on Companies' Retained Losses as a Percent of Surplus
100 Largest Writers of PRIA Covered Lines

Source: SNL Financial and authors' calculations.

Table 2
Statistics on Companies' Retained Losses as a Percent of Surplus
100 Largest Writers of Commercial Multi-Peril and Fire Insurance

Source: SNL Financial and authors' calculations.

Determining the provisions that would govern participating insurers' share of losses under this program presents a conundrum. If private insurers' share of losses would be small, this raises the question of what would be the point of having insurers bear any risk, understanding that even low deductibles and pro rata shares may be problematic for many companies. If the industry's share of losses would be large, then few (if any) responsible companies would likely want to participate. This leads us to consider alternative frameworks based on the NFIP or the federal crop insurance program.

There are further problems with claims handling due to the confusing mechanisms described in the bill, as well as the financial management and solvency of the participating insurers due to unclear timing of such claims payments because insurers might have to advance payments to insureds and await the Treasury's reimbursement, which is even more unreliable unless this program is prefunded. As there are sufficient problems with the conception and design of this program, we

a parametric method would be the use of a simple formula to determine what an insured business would receive. For example, if a certified public health emergency occurs in designated areas, all insured businesses in these areas would receive a payment equal to some percentage of their revenues or net income in the previous year.

Further, as with PRIA, there is the question of how many businesses would buy coverage offered by these alternative programs. We would expect that the likelihood that a business would purchase the coverage would depend on its owner's perception of their risk and the cost of coverage, among other factors.[32] One of these other factors would be the business owner's expectation that they could obtain government aid for their pandemic-related losses in lieu of insurance. As with PRIA, government aid for businesses that did not buy insurance offered by these alternative programs raises equity issues and could affect the take-up rate for this coverage going forward.[33]

# Concluding Thoughts

To summarize, there would be many challenges to creating a viable and efficient government insurance program for pandemic BI risk; Table 3 compares the key features of each program discussed in this paper. Despite these challenges, advocates of such a program might argue that it would still have several advantages relative to the status quo. These advantages might include reducing the uncertainty that many firms face with respect to pandemic-related losses, providing for greater economic stability, and creating a mechanism for pre-event financing.

Table 3
Comparison of Key Features of Programs

32. There is an extensive literature on the demand for insurance for catastrophic exposures that indicates that information problems, perceptions, and decision biases cause many individuals and firms to not buy insurance unless they are forced to. Kunreuther et al. (2019) contains several chapters on behavioral factors that influence decision making under risk and uncertainty.

33. This issue has surfaced with respect to federal disaster assistance for individuals and firms that do not have flood insurance.

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