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Proposed Virus Coverage Backstop Leaves Pricing In The Air

By **Jeff Sistrunk**

Law360 (April 17, 2020, 8:55 PM EDT) -- A proposed federal reinsurance program for pandemic risks that is under consideration by lawmakers on Capitol Hill may galvanize more insurance carriers to offer coverage for businesses' losses due to future viral outbreaks, but pricing such policies could prove difficult because of the dearth of historical data on large-scale pandemic events.

Earlier this month, Rep. Carolyn Maloney, D-N.Y., circulated a draft version of the Pandemic Risk Insurance Act of 2020, which would create a multibillion-dollar backstop for insurers offering business interruption policies that explicitly cover policyholders' losses due to disruptions in operations attributed to an outbreak or pandemic that leads to a federal emergency declaration. The bill is part of a raft of legislation being promoted by the House Financial Services Committee in response to the COVID-19 crisis.

While participation in the proposed reinsurance program would be voluntary, insurers that sign up would be required to offer pandemic coverage in all their business interruption policies. Participating insurers would collectively be responsible for covering the first $250 million of business interruption losses incurred by their policyholders. Once that threshold is reached, a federal fund administered by the U.S. Treasury Department would cover 95% of additional losses up to $500 billion in a single year, with the remaining 5% spread among the insurers.

In an April 8 "dear colleague" letter advocating for the measure, Maloney wrote that the Pandemic Risk Insurance Act would serve a purpose similar to the Terrorism Risk Insurance Act, or TRIA, which created a federal reinsurance program for terrorism risk coverage after claims from the Sept. 11 attacks slammed the insurance industry.

"Main Street's ability to recover from today's pandemic will determine the stability and viability of our national economy in the face of future pandemics," Maloney wrote. "An ounce of prevention is worth a pound of cure. The Pandemic Risk Insurance Act, or PRIA, would be an important step in our prevention efforts against future pandemics by both requiring insurance companies to offer business interruption insurance policies that cover pandemics, and creating a Pandemic Risk Reinsurance Program to ensure that there is sufficient capacity to cover these losses and protect our economy in the event of a future pandemic."

Crowell & Moring LLP partner Laura Foggan, who chairs the firm's insurance and reinsurance group, said the proposal could pave the way for more insurers to offer business interruption coverage for losses tied to future pandemics. Given the size of the potential risk, many insurers have limited their exposure to pandemics in recent years by inserting exclusions for virus-related losses.

Without some type of federal backstop, Foggan said, "it is just not possible for insurers under traditional policies to cover these kinds of losses."

"If we are going to move forward and create a marketplace for this coverage in the future, we need some protections for insurers in place," she said. "I think a program like PRIA would be an important underpinning for creating a marketplace where pandemic business interruption coverage can be introduced."

However, even the presence of a federal backstop may not be enough to entice more carriers to participate in the market for pandemic-related business interruption insurance. The COVID-19 pandemic is a rare event, and insurers don't have reams of historical data on similar events for reference; that would make pricing premiums a challenge.

"The premium must be fair and reasonable, but also accurately priced, which may be difficult to do," said Fred Karlinsky, co-chair of Greenberg Traurig LLP's insurance regulatory and transactions practice group. "There is not currently a lot of data to allow insurers to price these coverages accordingly, not only for the consumer but for the risk of loss and any reinsurance or other risk transfer mechanisms that they may use."

The PRIA proposal comes as the insurance industry is facing heightened pressure from policyholder advocates and some lawmakers to be part of a solution for businesses' financial woes following federal, state and local lockdown orders. The pandemic has already spawned dozens of lawsuits by companies seeking coverage under existing business interruption policies, as well as controversial proposals in several state legislatures and Congress that would retroactively force business interruption insurers to cover losses tied to COVID-19, notwithstanding the presence of any applicable exclusions or limitations on coverage.

McKool Smith PC principal Robin Cohen, who heads the firm's insurance recovery practice, said a forward-thinking program like PRIA could be an important piece of the puzzle for financially beleaguered policyholders. She said she expects that when many business interruption policies come up for renewal, insurers will "be looking to button them up in a way to preclude or very much limit any coverage for pandemics."

"Just as with the terrorism legislation, there is going to be a need for policyholders to be able to buy some sort of coverage to protect against future pandemics," Cohen said. "This proposal is a prospective move in light of what the insurance industry is likely to do on future policies."

But Cohen emphasized that she hopes the retroactive proposals will also gain traction, as a growing number of policyholders are in need of immediate relief as they look to dig themselves out from under the current pandemic.

"It is important that these legislative proposals are retroactive and deal with having the carriers reimburse the policyholders irrespective of whether they deem these losses to be covered under their policies," she said. "Since those proposals are retroactive, it appears that they could coexist with this prospective PRIA legislation."

By contrast, though, Foggan said the retroactive proposals are "extraordinarily troubling," as they may be vulnerable to constitutional challenges by insurers and don't acknowledge "the reality of the size of the losses collectively and the impact on the viability of the industry generally." The PRIA proposal, on the other hand, could be part of a viable long-term solution, she said.

"From the 20,000-foot level, we have had a number of proposals that are not constructive, a deep need for something immediate that is more constructive, and then a need for something that looks to the future. PRIA falls into that latter category," she said.

"The future is not that far off, because in many pandemic situations, there has been a resurgence," Foggan added. "We may need to have something in place before we get to a potential second wave."

Hinshaw & Culbertson LLP partner Judy Selby, who represents insurance companies, said it is unclear whether the proposed PRIA program would give insurers the necessary peace of mind to launch or expand business interruption coverage for pandemic risks. While the program is modeled on TRIA, terrorism events tend to be limited in geographical scope and duration, while "there is no safe place in this global pandemic, and it is extending for a long time," she said.

"I suspect a lot of insurers will take a look at this and consider the most fundamental issue, which is whether pandemics are an insurable risk, even with a government backstop," Selby said. "It is just such a massive and unpredictable exposure, and it is hard for one private industry to take on the financial impact of a truly national crisis."

A key question surrounding the PRIA proposal is how much participating insurance companies would have to pay the federal government for reinsurance premiums to fund the backstop, as insurers would ultimately pass those costs along to policyholders. If insurers wind up having to charge high premiums for business interruption policies with pandemic coverage, many companies may be dissuaded from purchasing them, according to attorneys.

"Particularly in the first few years, if this program is funded solely by reinsurance premiums, would they be able to get enough funding?" said Morgan Lewis & Bockius LLP partner Scott Fischer, who previously served as the executive deputy superintendent for insurance at the New York Department of Financial Services. "Without any capital, the question becomes how high premiums would be, and whether John Q. Public — for instance, a sole proprietorship or gig economy worker — would be able to buy these policies."

Insurance companies' efforts to accurately price policies under the PRIA program could be further complicated by the lack of historical loss data on major pandemics and the possibility that some insurers may lose pending court battles over coverage for policyholders' COVID-19 losses and be required to pay out millions on existing policies, according to attorneys.

While no court has yet issued a decision on the merits in a COVID-19 business interruption coverage dispute, many companies have argued in complaints against their carriers that the pandemic's spread fulfills the common requirement that a loss be tied to "direct physical loss or damage" to property. To bolster that argument, those policyholders pointed to the language of various government shutdown orders highlighting the novel coronavirus' ability to remain on surfaces for days.

In addition, at least one company has argued that the virus exclusion in its business interruption policy is unenforceable because it conflicts with a separate policy endorsement that expressly extends coverage for property damage caused by bacteria or viruses.

"Initially, insurers have discounted that they have much exposure to business interruption losses, raising various coverage defenses, including that there is no direct physical loss or damage and certain virus and pollution exclusions," said Morgan Lewis & Bockius LLP partner Jay Konkel, who represents policyholders. "However, many of these executive shutdown orders issued across the globe have been explicitly based on the propensity of the virus to spread and the proclivity of the virus to attach to property, thereby causing property loss or damage."

If PRIA becomes a reality, Konkel said, insurance carriers' ultimate decisions on whether to participate may be influenced by the outcome of the ongoing business interruption litigation and the retroactive legislative proposals. He noted that, in addition to capping participating insurers' share of business interruption losses, the PRIA draft bill designates federal courts as the exclusive forum for any coverage disputes.

"If coverage litigation continues to proliferate with some policyholder success, and state legislation broadens or clarifies policy terms removing certain insurer arguments to otherwise defeat coverage, the insurers' present calculus of what their ultimate exposure will be might be adjusted in the future," he said. "The question that insurers may then face is whether a federal program that would preempt some of this litigation and cap their exposure is more attractive than the world they may otherwise find themselves in."

--Editing by Brian Baresch.