

Testimony before the House Financial Services Subcommittee on Housing, Community Development and Insurance
“Insuring against a Pandemic: Challenges and Solutions for Policyholders and Insurers.”
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Good morning Chairman Clay and members of the Subcommittee. My name is Michelle Menendez McLaughlin, and I am the Chief Underwriting Officer, Small Business & Commercial Middle Market, at Chubb. Thank you for inviting me to speak to you today on behalf of Chubb regarding pandemic risk and our ideas for creating a public-private partnership that includes risk sharing by the insurance industry. As the COVID-19 pandemic has shown, pandemics are not only tragic in their impact on peoples’ health and lives but devastating in their impact on the economy and peoples’ livelihoods, as well. We believe that the insurance industry has an important role to play alongside the federal government in providing assistance to businesses in order to blunt the economic impact of future pandemics by keeping businesses open and people employed. Chubb’s plan creates a framework to do that, and I appreciate the opportunity to provide you with the details of our proposal.

By way of background, Chubb is the world’s largest publicly traded property and casualty insurer and the largest commercial insurer in the United States. With operations in 54 countries and territories, Chubb provides commercial and personal property and casualty insurance, personal accident and supplemental health insurance, and reinsurance to a diverse group of clients. Chubb has more than \$181 billion in assets and \$40 billion of gross premiums written in 2019. The U.S. accounts for approximately 60% of Chubb’s premium written. Chubb employs approximately 33,000 people worldwide, with over 16,500 of those employees in the 44 branches around the U.S. Chubb’s core operating insurance companies maintain financial strength ratings of AA from Standard & Poor’s and A++ from A.M. Best. Chubb Limited, the parent company of Chubb, is listed on the New York Stock Exchange (NYSE: CB) and is a component of the S&P 500 index.

Some risks can create losses so great that they are not insurable in the private insurance market without substantial government support, including catastrophic terrorism and pandemics. Pandemics, unlike other catastrophes like wildfires and hurricanes, are not limited to a specific geography, time period or risk class, but instead can affect entire economies and almost every business. The private insurance market cannot underwrite such massive losses. Thus, any pandemic insurance solution will require substantial involvement of the federal government: neither private sector investors nor the insurance industry has the financial capacity to underwrite a shutdown of the U.S. economy. In partnership with the federal government, however, the insurance industry can and should play a meaningful role in providing future pandemic risk coverage that would protect local and national economies and businesses small to large.

Recognizing the insurance industry's risk-taking role, Chubb has proposed a public-private partnership that can be implemented before the next pandemic. Our proposal would provide certainty to businesses so that they could keep employees on the payroll and avoid massive economic disruptions like those caused by COVID-19.

Our proposal has two elements: a program for small businesses that provides an immediate cash infusion when a pandemic is declared and a separate voluntary program for medium and large businesses with losses paid through the existing industry claims adjudication process. Both depend on the federal government assuming a substantial percentage of the risk, through direct U.S. Treasury funding for the small business program, and through a newly created government-run reinsurance entity for medium and large business losses.

Our proposal builds around five key attributes:

- 1. A program that provides a meaningful role for the insurance industry to share pandemic risk with the government.**

It is important for the industry to participate in the solution by sharing risk. Industry involvement in a public-private partnership will lead to better understanding of pandemic risk and incentivize improved risk mitigation and preparedness. A solution that commits insurance industry capital also provides an opportunity for increased risk-sharing over

time, as direct and secondary markets develop, thus helping to reduce the government's financial burden. We note that other types of risk, notably terrorism and flood, were once thought to be uninsurable, but now, with the government playing a role, private coverage capacity has become available.

2. A program structure recognizes the immediate needs of small business.

Pandemics do not impact all businesses equally. Generally, small businesses are at much greater financial risk than larger businesses and may face immediate shut-down because of their more limited financial resources, less liquidity, less access to capital, credit, and risk-management mechanisms than larger businesses. For these reasons, any pandemic insurance program must recognize and respond to the different needs of small business consumers.

3. A program that provides affordability and choice for small businesses, with strong incentives to purchase coverage and timely claim payments in crisis.

Purchase of pandemic coverage should not be mandated but should be strongly encouraged. Premium for a pandemic business interruption insurance policy must be affordable for small businesses, while also providing insurers with an appropriate risk-adjusted price for exposing their capital to loss. This will require significant government subsidies to take on the tail risk. While it is not mandatory for companies to purchase coverage, there would be a strong opt out and companies that choose not to purchase coverage would forgo access to future government pandemic assistance. Finally, to facilitate timely claims payments, the coverage should be based on pre-defined limits and triggers.

4. A program that provides effective incentives for broad participation by the insurance industry.

A pandemic program should be structured to encourage broad participation by insurers and create incentives for a new insurance market to benefit businesses, small and large.

5. A program that is fiscally responsible.

A pandemic insurance program with clearly defined mechanisms, triggers, and benefits will be less costly, more efficient, and more equitable than an ad hoc government relief program.

The Chubb Pandemic Business Interruption Program

The purpose of the Chubb Pandemic Business Interruption Program is to assist businesses and mitigate economic disruption during future pandemics through a private-public partnership that combines (i) the ability of the insurance industry to assess and absorb risk onto its balance sheet, while also using its administrative infrastructure to issue policies, collect premiums and handle claims, and (ii) the backing of the federal government (and subsidization of premium by the government) because, as we have noted, the magnitude of potential loss makes pandemic broadly uninsurable.

The Chubb proposal creates a framework with two main components in keeping with the key attributes discussed above: one component addresses the needs of small businesses and the other focuses on medium and large businesses. We have bifurcated the program because pandemics affect small businesses differently. Their needs are different and, therefore, they require a different approach than larger businesses.

Part one of the Chubb proposal is the Business Expense Insurance Program (BIP) for small businesses, which are defined as businesses with 500 or fewer employees. The BIP provides coverage for up to three months of payroll, plus other expenses such as rent and utilities for certain classes. Claims are paid under a parametric structure. That is, they are based on a pre-determined amount and paid automatically when the program is triggered (after expiration of a 14-day waiting period). This structure avoids the complexity of adjusting individual claims and provides policyholders with certainty by ensuring that small businesses know the financial assistance they will receive and that timely funding will be received after an event. The 14-day waiting period incentivizes good risk management by small businesses, which will need to maintain a level of short-term liquidity until the claims payments commence.

The trigger to determine a qualifying pandemic event is objective and uses medical and public health policy criteria. A pandemic triggers BIP payments if:

- (i) The United States Centers for Disease Control (CDC) has declared a pandemic in the U.S. caused by any human disease arising from a pathogenic microorganism and with an objective measure of catastrophic medical impact;
- (ii) A public health emergency has been declared by the U.S. Department of Health and Human Services (HHS) or a national emergency has been declared by the President; and
- (iii) State orders are issued closing or curtailing normal business activity.

Coverage commences on the date that the Treasury Department certifies that the requirements for a qualifying event have been satisfied. Pandemics caused by bioterrorism and COVID-19 are not covered by the Chubb program.

The program limit is approximately \$750 billion, split into two layers, with the private sector participating only in Layer 1. Layer 1 is a defined amount, set at \$250 billion. The industry's share is 6% of that amount (\$15 billion) in the first year, increasing to 12% (\$30 billion) over the 20-year life of the program. Each individual insurer's retention is based on its market share. Thus, an insurer with a 5% market share would be responsible for 5% of the industry's total liability in any one year. A smaller company, with less market share would assume less liability under the program. Layer 2, which is funded solely by the government, has a floating limit that is set each year according to the government's capacity. Based on payroll statistics, a reasonable estimate for Layer 2 in the first year of the program is \$500 billion.

To ensure timely payment of claims and avoid potential issues such as timing of cash-flow, allocation of limits, and post-event recoupment, a credit facility will be created. Both insurers and the federal government will provide first dollar claims payments, creating confidence and certainty to both businesses and insurers that the program will be funded and functional. The facility will be funded by the government up to the government's limit (excluding the industry's obligated amount) and will be available to draw down as needed for claims payments.

A BIP policy would be offered as an endorsement to a workers' compensation policy or a business owners policy (BOP). Insurers that offer such coverage would be required to offer their policyholders the option of purchasing a BIP policy. While not mandatory for companies to purchase coverage, there would be a strong opt out. Premiums would be affordable because policyholders would pay premium only on the insurers' portion of the risk (but not the larger government portion). Moreover, companies that choose not to purchase coverage would forego access to any federal assistance in the event of a future pandemic. We believe the reasonable rates, government subsidy, and federal assistance prohibition will lead to high take-up rates, perhaps exceeding 90%.

Part two of the Chubb proposal creates a federal reinsurance facility, Pandemic Re ("Pan Re"), for businesses with more than 500 employees. Medium and large businesses generally have more financial resources and options than smaller businesses. They may have greater liquidity, more access to capital, employ insurance risk managers, utilize captives, self-insure or use other risk management options. For these reasons, the impact of a pandemic on these businesses is not as immediate, and direct government assistance does not need to be as highly subsidized.

Chubb believes this issue can be effectively and efficiently addressed for medium and large businesses with a partnership between the private sector and the government where both parties take risk. The government would establish a reinsurance facility solely to cover pandemic risk, which would accept risks at commercial terms at a risk-adjusted price. Private insurance companies that choose to sell such coverage would write pandemic business interruption policies at market terms and retain some portion of the risk, reinsuring the rest to Pan Re. For the first five years, private insurers would cede 95% of the risk to Pan Re, retaining 5%, with a maximum industry aggregate limit of \$15 billion. Thereafter, private insurers would increase their retention gradually over time and decrease their cession to Pan Re from 95% to 90%, with a maximum aggregate limit of \$30 billion by year 10 of the program. Insurers could seek to reinsure or transfer the business interruption exposure to other private markets as appetite for excess limits develops, but Pan Re, when elected as reinsurer, would always accept risk. Additionally, Pan Re would be given the ability to purchase reinsurance (retrocession insurance) if a private market were to evolve over time.

Business interruption coverage would be written on modified standard industry forms, providing payment for business expenses (subject to proper claims verification) and triggered according to the same standards as described above for the BIP. Purchase would be voluntary, and insureds could elect 1-3 months of coverage, with a maximum payout of \$50 million per policy. Having a policy limit is an integral feature of the Chubb program, as large insureds could otherwise buy up much of PanRe's capacity quickly, limiting the number of companies that could access the program and potentially increasing the federal government's exposure. Insurers would set rates consistent with private market pricing, and Pan Re would charge market rates for the reinsurance provided. The government would benefit from the accrual of Pan Re's earnings and growth in book value. Policy administration, servicing and claims would all be handled by participating private insurers.

Pan Re's exposure depends on the take-up of the business interruption product by businesses. Our analysis suggests approximately 20,000 U.S. businesses would qualify to purchase coverage from participating insurers. If 30% of those businesses elect to purchase business interruption coverage at a \$50 million policy limit, this would equal \$300 billion of total risk exposure/maximum loss. In that instance, private insurers would absorb 5-10% (\$15-30 billion) and Pan Re's exposure would be \$270-285 billion. Pan Re would have a finite risk aggregate limit of \$400 billion representing the maximum potential obligation of the government and participating insurers.

Conclusion

The private sector cannot underwrite pandemic risk without federal government involvement. With government support, Chubb believes that the insurance industry can and should have a meaningful role in providing business interruption coverage as part of a public-private partnership. Industry's involvement will lead to greater understanding of pandemic risk, better preparedness, and improved mitigation. Chubb's Pandemic Business Interruption Program would establish a two-part program to address the unique needs of small, and medium and large businesses, with a significant risk-taking role for the industry, which will also provide its operational expertise to handle premium and claims.

We recognize that our proposal is one of several that have been suggested by policymakers, industry players, and policyholder groups in the past several months. The proposals differ in important ways, but a number of them include the essential elements of a public-private partnership and industry risk-taking. While our proposal may not answer all the questions, we hope that it encourages dialog and provides ideas for addressing future health crises that could have devastating effects on the lives and livelihoods of so many. We appreciate your interest in the Chubb program and look forward to working with you and the other stakeholders as your work on this critical issue continues.

Thank you.