

Testimony

Brian Kuhlmann

Senior Corporate Counsel, Shelter Insurance Company

On behalf of the American Property Casualty Insurance Association and the National Association of Mutual Insurance Companies

“Insuring Against a Pandemic: Challenges and Solutions for Policyholders and Insurers”

**Subcommittee on Housing, Community Development, and Insurance
Committee on Financial Services
United States House of Representatives
November 19, 2020**

Chairman Clay, Ranking Member Stivers, members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Brian Kuhlmann, and I am the Senior Corporate Counsel for Shelter Insurance Companies. Shelter is a mutual company headquartered in Columbia, Missouri. Our company was founded in 1946 primarily to serve the insurance needs of Missouri farmers. Since then, we have grown significantly and we now write auto, property, business, and life insurance in 21 states and also conduct business internationally. I am here today on behalf of the American Property Casualty Insurance Association (APCIA) and the National Association of Mutual Insurance Companies (NAMIC), which together represent more than 90 percent of home, auto, and business insurers in the country.

When the COVID-19 pandemic hit earlier this year, Shelter took prompt and strong actions to serve the needs of our policyholders. As a mutual company, we exist because of our policyholders, who have put their faith in us and expect us to be there when they have a claim. First, because many policyholders were under unprecedented stay-at-home orders and social distancing mandates, we recognized that they would be driving fewer miles and having fewer accidents. So, we voluntarily provided premium relief in the form a direct payment to policyholders of 30 percent of their personal auto monthly premium for the months of April and May. We were also among the first companies to continue to provide coverage when policyholders fell behind on their premium payments, including liberalized grace periods and working with policyholders in individual situations. Additionally, the Shelter Foundation is offering each of our nearly 1,400 Shelter agents \$1,000 to designate for a charity in their areas working to respond to local COVID-19 needs. Shelter is known for doing the right thing and we will continue to

evaluate this rapidly evolving situation and will do everything possible to help our policyholders, agents, and employees.

Our business is to help provide consumers with peace of mind by developing risk solutions.

Unfortunately, though, not every risk is insurable. Insurance works best to help people recover when the accidental losses of a few can be broadly spread. But where losses are catastrophic, unconstrained by geography, across the entire economy, insurance is not always an option to be the means of the relief many need. Global pandemics fall into this category of uninsurable risks.¹

As a general matter, risks must meet six tests to be broadly insurable². The unique aspects of pandemics and the associated risks they pose fail to meet all six:

First, insurers must be able to spread the losses of a few across a large number of exposures. COVID-19 is affecting tens of millions of businesses simultaneously. Even if insurers had provided such comprehensive business interruption pandemic coverage, the losses of many interrupted businesses would be spread across comparatively few insurers since there are far more businesses in need of coverage than there are insurers providing business interruption coverage.

Second, losses must be fortuitous. While pandemics may be fortuitous, the losses businesses are now experiencing are not; they have been caused by decisions made by government officials in the name of protecting public health. These deliberate acts by government officials, while perhaps necessary for the larger good in their respective states, add complexities that make an insurer's ability to model, predict, and anticipate losses from an event nearly impossible.

Third, losses must be determinable and measurable. As we sit here today, we are still in the middle of our first modern day, truly global pandemic; we have no certainty on either an end date or what the ultimate losses will be. We are now seeing extensive second waves of shutdowns taking place in Europe, but cannot now know whether similar or more severe shutdowns will be ordered throughout

¹ The National Association of Insurance Commissioners (NAIC) put it best when they told Congress in May that "insurance works well and remains affordable when a relatively small number of claims are spread across a broader groups. It is therefore not typically well suited for a global pandemic where virtually every policyholder suffers significant losses at the same time for an extended period."

² Principles of Risk Management and Insurance, 13th Edition-2017, George E. Rejda and Michael J. McNamara.

the U.S. Thus, it is not possible to predict whether there will be significant future losses, or if so, what the magnitude of those losses might be.

Fourth, losses must not be so catastrophic that they threaten insurer solvency. COVID-19 economic shutdowns have caused *trillions* of dollars in business continuity losses. If property casualty insurers were to assume all of those losses, they would exceed the annual industry revenues from business interruption coverage in a single day and would bankrupt the entire industry within a month.

Fifth, insurers must be able to model losses. While pandemics have occurred throughout history and are fortuitous, what has not occurred in the past are widespread government decisions to shut down entire economic regions. Risk models use data on past losses to predict future losses. But we are in the middle of our *first* data point for this type of loss, with long term impacts still unknown. Thus, traditional risk modeling techniques are not up to the task of projecting losses from future pandemics.

Sixth, insurance premiums must be affordable. Even if risk modeling could accurately predict future losses, the data related to global pandemic related business shutdowns would almost certainly dictate extremely high loss costs and premiums. With *trillions* in business continuity losses having already occurred and more possibly on the way, the premiums necessary to fund insurer coverage of such losses would inevitably be astronomical, even with an extensive government backstop. Even before COVID-19, very few businesses purchased business interruption coverage for pandemics because it was too expensive, particularly for Main Street businesses.

Because it is clear that global pandemics do not meet the requirements of insurability, an alternative mechanism will be necessary to protect businesses from future pandemics. Our industry believes that our expertise and infrastructure can play a valuable role in developing and implementing such solutions even if we cannot shoulder the financial burden of the U.S. economy.

We understand and are grateful that many of the members of Congress, on both sides of the aisle, have recognized that the magnitude of losses from this ongoing event means that the insurance industry cannot provide business interruption protection for pandemics. Observations from others have underscored this point. For example:

- The *Wall Street Journal* suggests that pandemics might cause as much as \$23.5 trillion in losses over the next thirty years.³
- The International Monetary Fund's chief economist, Gita Gopinath, estimated that pandemic related losses will cause over \$12 trillion in global economic losses over 2020-2021⁴
- In the U.S., government business continuity relief just for the past few months has run over \$3 trillion⁵, with more likely needed.

Even if the government were to backstop the industry for most of its indemnification obligations, this would not automatically render pandemic related closures insurable, nor would it necessarily lead to affordable premiums.

Indemnification obligations are also only a portion of the loss cost exposure for insurers. Average insurer expense ratios (which do not include loss adjustment or indemnification costs) have averaged 28.1 percent of premiums over the past decade⁶. However, business interruption claims adjustment expenses run at a much higher average because they involve sophisticated accounting forensics administered by specially trained adjusters. Insurers do not have nearly enough specialized personnel to be able to adjust millions of simultaneous business interruption claims.

This year, insurers are bearing the weight of near-record wildfire losses, hurricanes, civil unrest, and covered business interruption claims. The industry is handling those well and will continue to do so as long as its solvency is not threatened. However, the potential for additional, significant losses from a pandemic resulting in regional or nationwide non-backstopped losses could jeopardize the financial stability of a significant portion of the property casualty insurance industry.

Decades ago, our members recognized that they could only commit capital responsibly if they could accurately model and underwrite the individual risk frequency and severity and adequately diversify the potential solvency risk. Because pandemic business continuity risks cannot be accurately modeled, the industry has largely excluded coverage for losses related to viruses and communicable diseases. In 2006, those exclusions were reinforced in a manner that did not change the previously existing

³ The Wall Street Journal, "Global Viral Outbreaks Like Coronavirus, Once Rare, Will Become More Common", March 6, 2020

⁴ International Monetary Fund IMFBlog, "Reopening from the Great Lockdown: Uneven and Uncertain Recovery", June 24, 2020

⁵ In June CNN said, "Congress has already approved more than \$3 trillion in coronavirus relief."

<https://www.cnn.com/2020/06/04/politics/coronavirus-stimulus-relief-money/index.html>

⁶ National Association of Insurance Commissioners, U.S. Property Casualty Underwriting Expenses (10-year average: 2010-2019)

underlying intent to exclude pandemic risks. The filing made by the Insurance Services Office® states, “While property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic or hitherto unorthodox transmission of infectious material raises the concern that insurers employing such policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses, contrary to policy intent.”⁷

The insurance industry’s ability to provide coverage is also often dependent on the ability to obtain reinsurance. Reinsurers are now including broad exclusions for direct and indirect losses caused by communicable diseases. To provide the subcommittee with some insight into the breadth of these reinsurance exclusions, one of them reads “. . . this contract excludes any loss, damage, liability, claim, cost or expense of whatsoever nature, directly or indirectly caused by contributed to by, resulting from, arising out of, or in connection with a Communicable Disease or the fear or threat (whether actual or perceived) of a Communicable Disease regardless of any other cause or event contributing concurrently or in any other sequence thereto.” Out of necessity, insurers are filing coverage forms for approval in the states that align with the broad exclusions in their own reinsurance contracts. Because of the losses, both insured and uninsured, that we have already seen from the COVID crisis, business interruption and other forms of insurance will only be available to policyholders going forward because of these exclusions and the ability of insurers to responsibly manage their risk.

Business Continuity Protection Program (BCPP)

While the risk of government shutdowns is uninsurable, APCA and NAMIC have worked hard on potential solutions. We strongly supported the CARES Act and the Paycheck Protection Program (PPP) and were pleased that Congress worked so quickly, in a bipartisan way, to help our country’s businesses and employees. Given the unprecedented nature of this crisis, we believe Congress did a good job in developing a timely and appropriate response. At the same time, we asked ourselves what the PPP might have looked like if Congress had known the pandemic was coming and had the time to design the program in advance.

⁷ ISO Commercial Property Circular, LI-CF-2006-175, July 6, 2006, © ISO Properties, Inc., 2006

Our goal has been to leverage our own risk expertise to develop solutions that help the U.S. economy manage future pandemic risk. To do so, we have met with numerous stakeholders and businesses to discuss and refine our proposal. Even now, conversations continue to take place on the best role for the insurance industry to play as we address future pandemic events moving forward. Our discussions have led us to study the various relevant catastrophic protection models, including TRIA, the NFIP, Pool Re, and state disaster funds and FAIR plans. The model that was by far the most applicable is the War Damages Insurance Corporation (WDIC), which was created by Congress during World War II because potential property damage risk from the war was too potentially widespread and severe for the private sector to protect. It was recognized that claims could be too severe in magnitude and too numerous to process simultaneously and that coverage would be too difficult to model and too expensive for consumers to afford. As a result, the government underwrote the insurance and sold it through the insurance distribution system.

The risk characteristics that were present during World War II are similar to those that we face with the COVID-19 crisis. Thus, we used the WDIC as a beginning point for discussions that ultimately led us to propose the Business Continuity Protection Program (BCPP) – a revenue replacement program to protect the business community. We have revised our proposed program several times over the past six months, in response to recommendations from other stakeholders and the policyholder community. We support passage of the BCPP for the benefit of all stakeholders, especially Main Street businesses. *We are especially pleased to say that the BCPP has the support of over 90 percent of U.S. insurance underwriters and the nation's largest insurance agent group.*

The following are some key features of the BCPP.

Revenue Replacement

The program would provide revenue replacement assistance to businesses, which could purchase up to three months of protection for up to 80 percent of payroll, benefits, and other necessary expenses. With so many Main Street businesses in crisis from the current pandemic, we have heard repeatedly from risk managers and the business community that this product must be affordable to achieve high take-up rates. Therefore, pricing for the product would be federally subsidized.

Simple Application

There would be a one-page electronic application which would establish eligibility for potential future revenue replacement payments based on historic revenue shown on previous tax returns.

Parametric Trigger

The program would have a “parametric” trigger. Unlike the traditional insurance claims adjustment process, the parametric trigger would provide payments *automatically* upon the occurrence of certain events, i.e., a Presidential viral emergency declaration and a state-mandated closure. Businesses would be required to establish up front what their likely revenue losses would be, but would not have claims adjusted post-event. This greatly speeds the process of getting payments into the hands of businesses to provide immediate viability payments to protect businesses and ensure economic resiliency.

Resistant to Political Manipulation

Rules and relief formulas will be established *in advance* thus avoiding the need for adjusting claims, awaiting federal certification of an event, etc. The protection provided will be precisely aligned with state closure orders, which appropriately emphasizes the high stakes of a closure order.

Eligibility

Revenue replacement assistance would be available to any interested firm in the U.S. All for profit and not-for-profit entities are eligible without regard for size. Entities must enroll at least 90 days prior to a Presidential viral emergency declaration in order to receive assistance.

Distribution Channel

The product would be distributed to businesses via state-regulated insurers, agents, and brokers. Businesses electing not to participate would be required to affirmatively opt out in writing and would certify their understanding that opting out bars them from eligibility for any federal assistance in the event of a pandemic-related shutdown. This feature is designed to encourage businesses to buy the product, thus providing greater protection to the economy as a whole and reducing federal disaster relief costs.

Excess Program/Event Cancellation

An “excess” program would provide optional insurance coverage to businesses for losses not covered by the BCPP (i.e., risks other than business interruption). The precise lines of business to be included are still being discussed but will likely include event cancellation coverage. The excess program would also contemplate traditional state-regulated insurance products, with the risk being carried on insurers’ books but with a substantial federal backstop. For example: A restaurant with several locations could buy the 80 percent coverage under the BCPP and then purchase excess coverage through the private market for either a longer period of time (beyond the three months contemplated in the program or for the remaining 20 percent not paid under the BCPP).

Significant Insurance Industry Contributions to the Program

The insurance industry will be heavily involved in the provision of the BCPP product. In addition to playing a role in distributing the product to businesses by leveraging the industry’s existing infrastructure, insurers would also bear a portion of the risk for the excess program. Commercial reinsurers could also provide reinsurance protection to the federal government to protect its obligations under the program. The BCPP can be further adjusted over time to incorporate additional private sector participation if capital providers become more open to allocating capital to broader communicable disease risks.

What Distinguishes the BCPP from Other Proposals

While one alternative proposal has been formally introduced in Congress, numerous others are being discussed informally. While all of them have some positive features, the BCPP is the only one that could cover a recurrence of COVID-19 if it is established in time. This could be critically important given what historical precedents teach us about the nature of pandemics. The 1918 Pandemic is the only one of similar magnitude to COVID-19. In the United Kingdom, the second wave in the winter of 1918 caused five times as many deaths as the original outbreak, and the third wave in 1919 caused twice as many deaths as the first. COVID-19 cases are now resurging in most areas of the U.S. and in parts of Europe as well. Finding a solution that will help protect us from the current pandemic as well as future ones is vital. Thus, Congress should be careful to ensure that any program adopted can address the extraordinary current crisis we now face.

Proposals that provide business continuity protection that mirrors the coverage provided in business interruption insurance policies are also problematic. Traditional business interruption insurance coverage requires direct physical damage to premises before claims are paid. Courts and regulators have recognized that physical damage does *not* occur with COVID-19 claims.

The BCPP is also the only current public proposal that would be affordable for Main Street businesses. If insurers are forced to cover an essentially uninsurable risk, they would have to fully price in the uncertainty of further pandemics in order to protect their solvency. Even with a federal backstop, coverage will likely be far more expensive than most Main Street businesses can afford. Because pricing for the BCPP product would be federally subsidized, the cost could be made affordable for most of Main Street businesses, thus likely providing for a high take-up rate.

An important concern in the creation of any government program is cost to the taxpayers. Taxpayer exposure under the BCPP can be limited through offsetting charges for the coverage. Under most other proposals, the government receives no offsetting revenue, but protection is artificially capped at hundreds of billions of dollars. Artificial caps are highly problematic in that they severely undermine any uncertainty in the protection provided and incentivize a rush to closure. This is because states and business that close first may be able to have a higher percentage of their losses reimbursed, while subsequent losses above the cap might not be protected.

Finally, the BCPP is the only proposal that is supported by nearly all of the insurance industry, with APCA and NAMIC, representing over 90 percent of U.S. risk underwriters.

APCA and NAMIC are appreciative of the ideas and proposals brought forward by congressional leaders and the business community to address pandemic risk challenges. We are committed to working with you on solutions that can achieve the support of all stakeholders and can be enacted and implemented to provide affordable protection that works for all.