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Legislation to Nullify BI Exclusions Poses Existential Threat to P/C Insurers

Current legislation in the works in a number of states could have disastrous consequences for the P/C insurance industry

In the US, most commercial policies, including those that cover business interruption (BI), exclude losses caused by communicable diseases or viruses such as COVID-19. Despite these long-standing exclusions (which are well defined in contract terms), federal and state legislators are currently contemplating legislation that would force insurers to pay for COVID-19-related business interruption losses not currently covered. AM Best believes that these bills, if enacted, would have grave implications for the viability of the property/casualty insurance segment.

This legislation would not only deplete the industry's capital and surplus, but very likely also lead to widespread insolvencies. The effects of this legislation would most assuredly dampen the flow of capital to the industry, and affect pricing, the availability of reinsurance, and confidence in contract terms for years to come.

Standard Business Interruption Policies Exclude Pandemics

Standard BI policies provide insurance coverage and indemnify businesses for lost income when a peril specified in the insurance contract affects a business. A policy may cover operating expenses such as payroll, taxes, mortgage, rent, or lease payments, and it is usually bundled with a business owners' policy (BOP) or a commercial property policy. Among the common triggers for BI policies are natural disasters such as hurricane or fire.

Following the 2002-2003 SARS outbreak, insurers realized that they were not equipped to underwrite or price for aggregate losses due to a global pandemic. The Insurance Services Offices (ISO) released a virus exclusion in its July 6, 2006 circular. This exclusion was filed in all ISO states under the descriptor CP 01 40 07 06, with the key wording: "We will not pay for loss or damage caused by or resulting from any virus, bacterium or other micro-organism that induces or is capable of inducing physical distress, illness or disease." Many policies have used the regulator-approved ISO language in their insurance policy contracts to exclude for situations like the SARS and COVID-19 outbreaks.

The interpretation of some clauses in current BI policies will likely be determined in court, with insurers and clients undoubtedly vigorously contesting broad interpretations that could result in unintended coverage. We expect numerous, protracted and expensive legal battles especially regarding interpretation of contract terms such as property damage and civil authority coverage.

Legislation Would Upend BI Insurance Coverage …

To date, seven states have filed bills that would require insurers to pay for BI coverage—regardless of whether pandemics were a covered peril under the policy terms. Most of these states are contemplating payouts to businesses that have fewer than 150 employees. (New York is considering a limit of 250 employees.) AM Best believes the impact of any such legislation on the P/C insurance industry would be catastrophic, almost certainly compromising the financial ability of insurers to meet their existing financial obligations related to insurance coverage provided to individuals, families, motorists, state and local governments, and businesses. This would have a profoundly negative impact on all

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Exhibit 1
Pending Legislation in the US

State	Bill Name	Date Formally Introduced	Retroactive to Date	Notes
NJ	Assembly Bill 3844	3/16/2020	3/9/2020	The bill covers business interruption due to "global virus transmission or pandemic" and applies to businesses with up to 100 full-time employees where an FTE works 25+ hours per week. Coverage is subject to any limits under the policy and applies during the NJ state of emergency.
OH	House Bill 589	3/24/2020	3/9/2020	This bill extends "coverage for business interruption due to global virus transmission or pandemic during the state of emergency" and applies to companies with 100 or fewer "eligible employees," where an eligible employee works 25+ hours per week. It applies limits under the policy and applies for the duration for the state of emergency.
MA	Senate Docket 2888	3/24/2020	3/10/2020	The bill designates "covered perils under such policy coverage for business interruption directly or indirectly resulting from the global pandemic known as COVID-19, including all mutated forms of the COVID-19 virus." It applies to businesses with 150 or fewer employees and is subject to policy limits and any business interruption loss timeframes as stated in the policy. This bill will apply until the state of emergency is rescinded by the governor.
NY	A 10226 SB 8178	3/27/2020 4/13/2020	3/13/2020 3/7/2020	The Assembly bill states that "any clause or provision of a policy of insurance insuring against loss or damage to property, which includes, but is not limited to, the loss of use and occupancy and business interruption, which allows the insurer to deny coverage based on a virus, bacterium, or other microorganism that causes disease, illness, or physical distress or that is capable of causing disease illness, or physical distress shall be null and void." The Senate bill wording includes "...shall be construed to include among the covered perils under that policy, coverage for business interruption during a period of declared state of emergency due to the coronavirus disease 2019 (COVID-19) pandemic." The Assembly bill applies to businesses with 250 or fewer full-time employees, the Senate bill, to businesses with 100 or fewer employees. Both bills state that an "Eligible Employee" works 25+ hours each week and that policies are still covered up to their policy limits for the duration of the NY state of emergency.
LA	Senate Bill 477 House Bill 858	3/31/2020	3/11/2020	The Senate bill grants coverage for business interruption due to the imminent threat posed by COVID-19, as provided in Proclamation Number 25 JBE 2020." The house bill grants "coverage for business interruption due to global virus transmission or pandemic, as provided in the Emergency Proclamation Number 25 JBE 2020." The House bill would apply to businesses with 100 or fewer employees; the Senate bill does not address the number of employees. Both bills limit losses to applicable policy limits. The Senate bill would apply for the duration of the state of emergency, while the House bill would be valid for an undetermined period.
PA	House Bill 2372 Senate Bill 1114	4/3/2020 4/15/2020	3/6/2020 3/6/2020	The House bill states that BI policies "shall be construed to include among the covered perils under the insurance policy coverage for business interruption due to global virus transmission or pandemic." The Senate bill states "shall be construed to include among the covered perils coverage for loss or property damage due to COVID-19 and coverage for loss due to a civil authority order related to the declared disaster emergency and exigencies caused by the COVID-19 disease pandemic." The House bill would apply to businesses with 100 or fewer "eligible employees"–those working 25 or more hours per week. The House bill states that the highest policy limit and lowest deductible would apply for the duration of the disaster emergency. The Senate bill is subject to the maximum policy limit, where "small businesses" will have 100% of their limits available, while other businesses will have 75% of their limits available. Small businesses are determined by the US Small Business Administration criteria.
SC	Senate Bill 1188	4/8/2020	No firm retroactive date	Policies shall be construed "to include among covered perils … the global pandemic known as COVID-19, including all mutated forms of the COVID-19 virus." The wording mandates virus coverage even if policy wording excludes viruses and states that a claim may not be denied if there is no physical damage to the insureds or other relevant property. Coverage is limited by policy limits and the stated maximum length of time. The bill applies to businesses with 150 or fewer FTE employees and applies to policies in force as of the governor's state of emergency declaration until it expires.
USA	H.R. 6494	4/14/2020	3/6/2020	The bill makes business interruption insurance cover losses from "any viral pandemic ... any forced closure of businesses, or mandatory evacuation, by law or order of any government or governmental officer or agency, including the Federal Government and State and local governments." It voids any exclusions that under normal circumstances would prevent insurance coverage as described in the bill on the day the bill is enacted. Insurers can subsequently re-instate pre-existing exclusions. As written, the bill applies to businesses of all sizes.

Source: AM Best data and research

consumers and businesses that rely on the insurance market for protection and could have a destabilizing impact on the P/C insurance industry as well as the broader economy. Many of these bills contain wording that allows insurers to seek reimbursement from a state's department of insurance, but any reimbursement would ultimately come back from the industry in the form of assessments based on market share. Insurers would need to pass these assessments on to their policyholders, which could result in a significant increase in rates.

Based on our analysis many insurers may not be able to fulfill these extra-contractual obligations and their solvency will be threatened. Also concerning to insurers is the inviolability of contract wording. Insurers would not be able to trust regulator-approved policy wording if it can be selectively revoked owing to political pressures. More broadly, contract law in the US would be undermined by such a decision. **Exhibit 1** describes current legislation in the works.

Business interruption coverage is typically triggered by events causing direct physical loss covered by a commercial insurance policy, such as fire, vandalism, burst pipes, and windstorms. The bills currently under consideration attempt to retroactively put business interruption coverage in place for the loss of use and occupancy of physical premises. Such legislation would sanction interpretation contrary to the policy's original intended coverage.

… and Result in Potentially Severe Losses …

Using US Census Bureau statistics, AM Best has estimated total economic losses for small businesses with fewer than 100 employees at $294 billion per month owing to business interruption. This estimate takes into account that some industries (such as accommodation and food services) have been particularly hard hit by the business closures, whereas the impact on others (such as finance and insurance) is somewhat mitigated by their employees' ability to work remotely.

From this estimate of economic loss, AM Best's has calculated a potential impact from the legislation of $150 billion to $200 billion per month for insurers. The insurers most at risk would be those that specialize and have concentrations in small to medium-sized business insurance.

To provide some context, **Exhibit 2** shows that, over the last two decades, the two worst losses in policyholders' surplus occurred in 2001 and 2008: 8.4% in 2001 largely attributable to the 9/11 terrorist attacks on the World Trade Center and 12.3% in 2008 owing to the Great Recession. The impact of both of these events was far-reaching and hurt small and larger businesses alike. Court-mandated

Exhibit 2
US P/C Industry – Policyholder Surplus, 1999-2019
($ millions)

	PHS	YoY % Change
1999	339,893	0.3
2000	325,944	-4.1
2001	298,719	-8.4
2002	294,791	-1.3
2003	358,150	21.5
2004	402,123	12.3
2005	437,636	8.0
2006	503,398	15.0
2007	538,969	7.1
2008	473,338	-12.3
2009	534,945	13.0
2010	583,960	8.8
2011	574,750	-1.6
2012	611,477	6.4
2013	682,245	11.6
2014	705,429	3.4
2015	705,719	0.0
2016	735,059	4.2
2017	786,054	6.9
2018	780,087	-0.8
2019	873,944	12.0

Source: AM Best data and research

payments for COVID-19 BI losses that resulted in a monthly cost in the range of AM Best's estimate would have a devastating effect on the P/C insurance segment's ability to provide protection to individuals and businesses and indemnify them for covered losses.

Reinsurers would also be affected by the legislation, as contract interpretation—and the uncertainty—would extend to reinsurance contracts. Furthermore, reinsurers are based in a number of different domiciles, subject to varying jurisdictions, and these disputes could play out globally.

…And Cause Significant Ratings Downgrades

Based on our analysis of US PC statutory statement data, we estimate that $633 billion of insurers' surplus could be exposed to business interruption losses. Our estimate is based on the combined surplus of commercial lines insurers and reinsurers that have exposure to commercial multi-peril or property lines, and personal lines insurers that also underwrite commercial multi-peril exposures.

Our estimate of insured business interruption losses of $150 billion to $200 billion per month for a closure of two months would result in an after-tax surplus loss of 37% to 50%. A significant number of companies would see their BCAR assessment transition downward as **Exhibit 3** shows. At the upper end of our estimated potential loss, companies with Strongest assessments would decline to 32% from 82%, and 25% of insurers would have BCAR assessment levels of Weak or Very Weak. The exhibit underestimates the drop in BCARs because the losses are allocated based on market share. In reality, small to medium-sized regional commercial writers with concentrations in BOP & CMP (commercial multi-peril) will be hit the hardest. For every large company that survives the loss, there would be multiples of smaller insurers who would be insolvent. In addition, our analysis has focused primarily on the underwriting impact. These impacts will most certainly be exacerbated by the decline in equity valuations, and the deterioration of credit conditions, that together have caused sharp drops in asset values.

BCAR assessments are not the sole determinant of an insurer's balance sheet strength; we review many other factors, such as reinsurance, diversification, and liquidity, to evaluate balance sheet strength. However, a significant deterioration in the BCAR assessment would lead to the downgrade of an insurer's financial strength rating. Based on the figures above, many insurers would experience multi-level downgrades with some falling below the "B+"/"bbb-" (secure) rating level (**Exhibit 4**).

Exhibit 3
US PC Groups and Unaffiliated Singles Exposed to Business Interruption – BCAR Assessment Levels
(%)

BCAR Assessment	Original Distribution	Distribution of Low End of Estimated Loss Range	Distribution of Midpoint of Estimated Loss Range	Distribution of High End of Estimated Loss Range
Strongest	82	62	47	32
Very Strong	10	14	17	15
Strong	3	11	14	17
Adequate	1	5	7	11
Weak	2	4	9	17
Very Weak	2	3	5	8
Total	**100**	**100**	**100**	**100**

Source: AM Best data and research

Severe Consequences for Recovery Efforts

Over the medium term, actions that require insurers to provide retroactive coverage could threaten a significant portion of the industry, whose role it is to protect policyholders against

Exhibit 4
AM Best – Overall Balance Sheet Strength Assessment

Combined Balance Sheet Assessment (Rating Unit/ Holding Company)	Country Risk Tier				
	CRT-1	**CRT-2**	**CRT-3**	**CRT-4**	**CRT-5**
Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb
Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-
Strong	a-/bbb+	a-/bbb+	bbb+/bbb/bbb-	bbb/bbb-/bb+	bbb-/bb+/bb
Adequate	bbb+/bbb/bbb-	bbb+/bbb/bbb-	bbb-/bb+/bb	bb+/bb/bb-	bb/bb-/b+
Weak	bb+/bb/bb-	bb+/bb/bb-	bb-/b+/b	b+/b/b-	b/b-/ccc+
Very Weak	b+ and below	b+ and below	b- and below	ccc+ and below	ccc and below

Source: Best's Credit Rating Methodology

a variety of risks (including damage to property, motor accidents, workplace injury and many other events). Over the longer term, retroactive coverage would cause any remaining insurers to significantly re-think their options in terms of offering much needed capacity. Risk management and ratings agencies would also have to contemplate contract viability in addition to the risks that insurers seek to cover.

The devastating impact of the COVID-19 outbreak on the economy and small businesses cannot be overstated. These are extraordinary circumstances and as elected representatives plan for the recovery, they must remember that a healthy and well-functioning insurance industry is essential to any economic recovery—allowing businesses to position for the recovery knowing that their insurers will be financially capable of honoring the terms of the insurance contract and indemnifying the business owners for covered losses. Legislative actions that seek to negate contract law may impede the flow of capital to the industry and insurers' confidence to provide protection.

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