Thank you for participating in ESLR’s When the Second Shoe Drops: COVID-19 Losses and Reinsurance. Below are questions presented to the panel during the Webinar on May 8. The panel has provided short answers to those questions. These questions and answers are being provided as a courtesy as part of an ABA CLE presentation and are not legal advice or provided in the context of an attorney-client relationship. Every policy is different and every fact situation is different and must be examined independently by competent counsel.

It's my understanding that the legislation is OPTIONAL for the insurers. What incentive do the carriers have to step up and sign up for these retroactive coverages?

PRIA legislation is optional for insurers just like TRIA. The state and federal retroactive BI coverage bills are not optional. They mandate that every insurer that issued a property policy with BI coverage as of March __ 2020 (most early March), must pay all BI claims arising from COVID-19 regardless of physical damage requirements or viral exclusions.

If business interruption coverage is mandated retroactively by state statutes, will reinsurance apply to claims made pursuant to those statutes?

That is one of the $64,000 questions. As Daryn said, if the reinsurance contract has language stating that the reinsurer must follow any changes to the policy, including changes in law, then it would seem likely that reinsurers will have no choice. If the reinsurance contract is silent on that subject, then cedents likely will analogize the situation under follow-the-settlements and follow-the-fortunes principles to a court judgment mandating coverage when coverage was not contemplated. Judicial challenges to these statutes, if enacted, would complicate matters depending on whether stays or injunctions are granted pending review.

Do you expect that the legislation designed to "force" coverage for business interruptions will include captive insurance companies?

The bills we have reviewed do not distinguish between captive carriers and non-captive carriers. If the captive is domiciled in the state or is licensed or authorized to do business in that state, and that state enacts a retroactive BI law, then the captive likely will have to pay those losses on its policies just like any other insurance company.

An interesting dynamic for discussion is the possible impact of the proposed federal or state 'immunity' legislation on insurers and policyholders going forward.

The immunity legislation aimed primarily at businesses, individuals and entities that may be subject to lawsuits by others for actions taken during the pandemic. This will provide insureds with defenses, which will lessen both the expenses in defending a lawsuit and potentially eliminate any indemnity payments, which will mean direct insurers of those defendants, if coverage applies (mostly liability), will have lower loss payments. I have not seen any suggestion that insurance companies will receive “immunity” from coverage. Quite the opposite.
How will the 50 state dynamic impact reacting to these issues? Do you anticipate a recall of FIO to prominence? Especially solvency issues?

Interesting question. If insurers are forced to pay billions in business interruption claims on property policies that were never written to cover a pandemic, there will be significant, if not catastrophic, solvency issues for the entire property and casualty industry, and regulators will do whatever they can to prevent that from happening. I don’t think this will spur more prominence for the FIO. The NAIC and insurance trade associations are all on the same page on this one.

Where can we find the transcripts just mentioned?

The earnings call transcripts for public insurance companies can be found on various aggregation sides like Motley Fool, Edgar and on each public company’s website under their financial pages.

What is necessary to claim advice of counsel privilege?

As you know, attorney-client privilege requires a confidential communication between a client and the client’s lawyer where the client is seeking legal advice. In the cedent/reinsurer relationship, this has been a controversial subject where cedents wish to avoid claims of waiver of privilege on underlying claim files because of defense or coverage counsel reports being shared with reinsurers. In the context of these BI claims, advice cedents may obtain from coverage counsel on whether their policies must respond to COVID-19 BI losses and, if so, how those losses may be aggregated for reinsurance purposes, is something they would want to keep confidential.

How do you avoid communication with brokers causing waiver of attorney client privilege?

If a confidential communication concerning the seeking and providing of legal advice is provided to a broker the privilege is technically waived. The only way to avoid waiver is by not providing the broker with that type of communication.

Does the panel believe that retro BI cover will cover entire policy? Eg, Professional Fees

No. The proposed legislation only discusses the business income and extra expense, including civil authority order coverage grants under the overall property coverage grant. None of the proposals open up the entire policy for other coverage grants. These bills are meant to force insurers to pay COVID-19 BI claims because of the closures from the stay-home orders. If professional fees are part of an extra expense claim, they may be covered but that will depend on the specific facts and policy provisions.

What is the closest historical parallel to use as precedent?

The closest parallel to the novel coronavirus pandemic is the 1912 pandemic and the more recent experience with SARS. On the legal issues, the parallels are to coverage issues arising out of hurricanes, September 11 and similar exposures that closed down businesses. If you go to InReDisputesBlog.com, you will find various posts analyzing many of these legal issues with citations to cases from the types of incidents mentioned above.
Are non COVID-19 claims under CGL policies going to be impacted, e.g., solvency concerns or delay?

Non-COVID-19 claims have been impacted in various ways because of the pandemic and the stay-home orders. Claims personnel are all working from home and the way claims are being adjusted has changed. Claims in suit have been either slowed down or suspended as courts were shut down in many parts of the country. If insurers are forced to pay COVID-19 BI losses, those companies’ ability to pay non-COVID-19 claims may be impacted. On the other hand, the volume of many non-COVID-19 claims are way down and many claims are being settled because of the court delays.

The cedent’s not paying would want to look at XCO

There is the danger that insurers who do not respond to COVID-19 BI claims properly will face bad faith-type allegations (many are facing those allegations in some of the suits filed to date), which could result in a judgment in excess of policy limits or just a bad faith judgment. If cedents are hit with ECO or XPL, they may have the ability to cede some of that exposure if their reinsurance contracts allow it.

Would payment into an escrow fund pending challenges to the constitutionality of the statute work?

Only if permitted by state law or agreed upon with the policyholder’s counsel. But if the payment is so large that it causes an insolvency, it won’t matter.

Have you seen any regulatory response from the pending statutes

The NAIC has made numerous statements opposing the retroactive legislation. We understand that individual state regulators are communicating their solvency and abrogation of contract concerns with their counterparts in the state legislatures.

Would there be coverage under policies to refigure workplaces to reopen business

I think the answer is no. Business Income and Extra Expense provisions do not cover changes like that. The Business Income part only replaces income. The Extra Expense part covers necessary extra expenses incurred by the insured during the period of restoration that the insured would not have incurred if there had been no direct physical loss of or damage to property caused by or resulting from a Covered Cause of Loss. It includes the cost to repair or replace property, but only to the extent it reduces the amount of loss that otherwise would be payable under the BI coverage form. Reconfiguring workspaces to reopen a business is not an expense that was incurred because of direct physical loss of or damage to the property.

Thanks for that response, and I get that. But I guess what I am asking is why policies are not crystal clear in terms of liability for viruses.

Some policies, which have incorporated a virus exclusion, are crystal clear. ISO issued a virus and bacteria exclusion in 2006 after the 2005 SARS pandemic. See CP 01 40 07 06. The history of that exclusion indicates that it was a belt and suspenders provision for those companies that wanted to use it
and that there was never coverage for virus and bacteria under property policies unless there was a specific coverage grant for it. When read in context, the BI provisions are clearly property coverage extensions tied directly to actual physical loss of or damage to property. A virus does not cause direct physical loss of or damage to property so there is no reason to think it is covered.
Reinsurance And COVID-19

by
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Commentary

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Reinsurers, like insurers, are assessing their exposure to potential COVID-19 losses. There are, of course, many considerations. These include: (a) whether the loss comes within the terms and conditions of the underlying insurance policy; (b) whether a cedent’s loss payments were made on an *ex gratia* basis; (c) whether civil authority orders change the dynamic; (d) understanding which lines of business are affected; (e) whether reinsurance contracts allow for aggregation of COVID-19 losses as a single occurrence; and, (f) whether a reinsurer has too much COVID-19 concentration. Reinsurers are struggling with issues like maintaining a work force, either on site or remotely, and determining whether reinsurers are essential businesses under the myriad state business closure orders.

One thing is clear, all the issues that insurance companies are facing, both on the life and health side and the property and casualty side, are issues that reinsurers will be examining when receiving claims from cedents. Because the reinsurance industry is the natural financial backstop for the insurance industry, it is critical for reinsurers to continue operations to address the claims as they come in and support their cedents in assessing the myriad insurance issues arising from the COVID-19 pandemic.

This article will focus on issues from the property and casualty perspective, but many of the same issues arise in the life and health context as well.

What Do Reinsurers Do First?

The first thing reinsurers will do is review their assumed portfolio to determine where potential COVID-19 claims are likely to come from. Reinsurance contracts run the gamut from broad quota share and whole account protections to excess-of-loss contracts on specific lines of business to facultative certificates for specific policies. Reinsurers will need to assess their line of business spread and determine where the concentrations are for possible COVID-19 loss cessions. Once identified, reinsurers have to look at the terms and conditions of the ceded policies.

Because of the massive disruptions happening now with voluntary and mandatory business closures, commercial property reinsurers are watching closely for business interruption, contingent business interruption and supply chain losses arising from COVID-19 shut downs.
As thousands, if not millions, of businesses close because of civil authority orders or because of supply chain disruptions, the first tranche of losses that reinsurers might see will be from the business income and extra expense coverages on their assumed property portfolios.

Clearly, this will be a contentious area as already can be seen with the start of coverage litigation between policyholders and insurers over the terms and conditions of business interruption coverage provisions. Reinsurers will be watching (and perhaps assisting where appropriate) as insurance companies and policyholders battle over the meaning of what many in the insurance industry consider clear and unambiguous policy language requiring direct physical loss or damage to property.

Moreover, this issue can blow up completely if state legislatures, or the federal government, intervene and pass laws retroactively directing insurers to provide business interruption coverage in spite of unambiguous exclusions or clear policy language requiring specific triggering activities. More about this later.

What Are Some of the Key Insurance Issues and Exposures?

There are myriad articles on COVID-19 and business interruption from the policyholder perspective and from the insurer perspective discussing many of these issues. Some of the key issues include the requirement of direct physical damage or loss to insured property by covered loss requirements, waiting periods, civil authority orders and exclusions for losses arising from virus and bacteria exposure.

Going beyond business interruption, reinsurers will be looking at directors and officers exposures. There are several securities class action cases pending against cruise lines, and others, because of alleged wrongdoing associated with responding to COVID-19. Reinsurers will also be watching general liability exposures. Here too, passengers who boarded ships after prior passengers disembarked with COVID-19 diagnoses are suing cruise lines. Those passengers are alleging negligence in failing to sanitize and failing to warn subsequent passengers about prior passengers who were later diagnosed with COVID-19.

No doubt, other businesses, including healthcare businesses and governmental entities, will face lawsuits for negligence for failing to warn about COVID-19 exposures, or allowing third parties to come in contact with exposed or contagious employees. Workers compensation insurers, of course, will see an uptick in claims because of “essential” employees who, while working, contract COVID-19 and be out of work for significant periods of time. Disability insurers likely will see an uptick in claims as well. Insurance companies that wrote event cancellation coverage are being inundated with claims.

In other areas, there may be a claims slowdown. For example, less people on the road means less vehicular accidents. Traditional slip and falls in businesses will also lessen as so many businesses are closed. Traditional workplace accidents also should decrease temporarily with the closure of businesses.

Because of the many statewide closure orders, reinsurers will be watching for property exposures from fire, flood and vandalism that may rise because buildings, residences and other property is essentially abandoned. Reinsurers will have to work with their cedents to use technology or other means to make sure closed businesses do not become loss-producing sites. COVID-19 makes this all more difficult because of the closure orders, the need for social distancing, and the loss of employees from either layoffs or illness.

What Are Some of the Key Reinsurance Issues?

No doubt, follow-the-fortunes/follow-the-settlements issues will arise if cedents choose to pay business interruption claims and cede them to their reinsurers. For example, what if a ceding company accepts and pays COVID-19 losses based a determination that the virus is causing direct physical damage to insured property? Is that something that reinsurers will also accept? The answer to that question depends on various factors. First, the specific reinsurance contract wording is key to determining whether a loss cession is proper. Second, the facts of the underlying loss, and whether that loss fits within the actual terms and conditions of the ceded policy, are critical to determining a reinsurance claim.

A critical point of reinsurance contract wording analysis is whether the reinsurance contract broadly or narrowly defines the ceding company’s right to determine the losses ceded to the contract. Does the reinsurance contract have traditional clauses that allow the cedent to
determine the loss and require the reinsurer to follow the determination of the cedent? Does the reinsurance contract provide that the cedent is the "sole judge" on determining whether a loss can be ceded?

Modern reinsurance contracts do not all have the traditional follow-the-fortunes or follow-the-settlements clauses or the traditional utmost good faith language that older reinsurance contracts often contained. If the reinsurance contract does not have language requiring the reinsurer to follow the cedent’s claims determinations, it is more likely that the cession of a COVID-19 loss under a business interruption cover may be rejected by a reinsurer on the basis that there is no direct physical loss and that COVID-19 is not a covered peril. But, if the reinsurance contract has a more traditional follow-the-settlements clause, does that make a difference?

Cedents will argue that under a traditional follow-the-settlements provision a reinsurer must follow its claims determination and pay the loss. Reinsurers, on the other hand, will argue that the claims determination has to be made in good faith and businesslike to be followed. The traditional principles of follow-the-settlements support the notion that if the cedent pays a claim reasonably and in good faith, and the claim falls within the terms of the underlying contract and the reinsurance contract, the reinsurer must pay, and the reinsured’s claims determination will not be second-guessed.

Disputes over cessions of COVID-19 business interruption losses, if they happen, likely will focus on whether the payment was reasonable, made in good faith and comes within the terms of the ceded insurance contract and the reinsurance contract. If the underlying contract has the virus and bacteria exclusion, it will be very hard for a cedent to seek reinsurance coverage for a COVID-19 claim under those circumstances. If the business income and extra expense coverage, as it normally does, requires direct physical damage or loss to covered property by a covered cause of loss, the dispute will come down to whether a virus can cause direct physical damage. But, if these provisions are absent or if the underlying policy covers contagion, the reinsurance response may be different.

This issue will only be exacerbated if legislative intervention directs insurers to pay insureds for business income and extra expense coverage even if a virus and bacteria exclusion exists and even if there is no direct physical damage to property from a covered peril. Even if legislation does not retroactively force insurers to provide coverage, what if regulatory pressure compels cedents to pay claims on a “voluntary” basis that they would not ordinarily have paid? Most reinsurance contracts do not allow for the cession of ex gratia payments. Will reinsurers feel the same market/regulatory pressure to fall in line? Then what happens at the retrocessional level, especially if the retrocessionaires are outside the US?

Another significant issue that reinsurers may face is the prospect of COVID-19 losses being aggregated as one event or one occurrence under property catastrophe or other reinsurance contracts that contemplate aggregation of losses. This complex issue depends on the reinsurance contract wording and especially the definitions used for the aggregation language. A critical review of aggregation language will prepare reinsurers for potential cessions of COVID-19 losses as one event.

Conclusion

The COVID-19 pandemic is not unlike other disasters the insurance industry has faced in the past. No doubt, the reinsurance industry will respond appropriately. That response, however, will be consistent with the reinsurance contract wording and commensurate with the premium charged for the reinsurance. While reinsurance is the backstop for the insurance industry, it is not the backstop for the country. While the insurance industry is financially strong and able to weather this event, expecting insurance and reinsurance to solve all problems, even those not covered by clear and unambiguous policy wording, is unwarranted.

As the underlying coverage issues play out, reinsurers will be prepared to respond accordingly.
COVID-19: Issues in insurance regulation

Insurance regulators spend a great deal of time on activities designed to insulate their insurance company charges from instability. That is a difficult objective in the best of times, but when economic shocks, such as the current virus plague, turn up, it becomes even more challenging.

Reinsurance plays a key role in cushioning insurers from economic shocks, -- but only if the reinsurers themselves prove capable, and willing to, step up.

Having access to a diverse and international pool of reinsurers benefits the cedent when localized catastrophes strain the cedent’s resources. But a pandemic turns the tables: when many of the reinsurers are exposed to the same global catastrophe as has beset the cedent, the cedent may find that his reinsurers are in no better position to pay claims than he is. Nevertheless, reinsurance, including (and even especially, non-admitted reinsurance, offers an important degree of protection to risk-bearing Americans.

In previous cycles, distrust of the credibility of reinsurers in far-off lands led some regulators to pressure US cedents to “cash out” treaties, especially those with non-admitted counterparties, at a steep discount via commutation. In some cases, these commutations avoided catastrophic loss for the cedents, especially those who were alert enough to move early. But in hindsight, it was often a mistake. The cedents own loss estimates have sometimes proven optomistic, leaving them unprotected against loss development the reinsurers would have shared. The lively market that developed for “run-off” operations is an indicator of how much money those commutations left on the table.

Memories in insurance regulation are not always long, and a new generation of insurance regulators now mans the US insurance ramparts. A generational change has introduced new commissioners, deputies and analysts to the industry, and memories fade. Notwithstanding the human impulse to distrust foreign capital, it is imperative that those regulators understand the value of reinsurance, to the survival of their companies in difficult times, and the value of geographic diversity in reinsurance. If it does no other good, the COVID pandemic may provide a refresher course in the importance of maintaining insurers’ access to a broad base of reinsurance capital.
Insurance regulators see their first responsibility as the protection of the insured public from misconduct or irresponsible behavior by insurers.

Misconduct in this context covers a multitude of sins, but most of them fit into three categories:

   - **Overselling** – marketing on a basis which elicits false and unrealistic expectations of the offered coverage;
   - **Underdelivering** – inept, improper, or delayed claim handling, leading to failure of prompt settlement or denial of valid claims,
   - **Hazardous operation** – a business plan (or lack of one) that exposes the insurer (and more importantly, its insureds) to an unreasonable degree of risk that the insurer will be unable to promptly and fairly settle claims, or response to potential loss events which, while protective of the insurer, amounts to a failure of performance of contracted obligations.

Regulators view reinsurance as part of the insurer’s system of protections against failures arising out of large loss events. Done well, their supervision of insurers includes the imposition of requirements that, if an insurer bolsters its apparent solvency by ceding
reinsurance, that the reinsurance, and the reinsurer, are of a kind and quality that can
survive a catastrophic claim scenario, and will, in fact, perform timely and fully. There is
an inevitable tension between the regulator’s risk aversion and tendency to back-seat
drive, and the insurer’s desire to respond nimbly and profitably to opportunities that carry
risk.

The responsibility regulators like least, however, is their duty to ensure that, if a disaster
so large as to threaten the survival of an insurer, or even a whole category of insurers,
that the policyholders and claimants are treated equitably and receive, if not exactly what
they are entitled to, then at least a fair share of the insurance company’s pot. This long
and often painful process will almost certainly snare both insurers and reinsurers who
may have underestimated their exposure to pandemic risks.

In advance of disaster, many plans can be made, wording arranged, and reserves set aside
which, in theory, should be adequate to ensure that the insurer has made only promises it
can keep, and has provided itself with the means to do so. But when it comes to very
large, infrequent or unheard of loss clusters, that theory may prove wrong. COVID-19
may prove to be, for some hapless insurers, a non-survivable event.