Public Policy Post-COVID: TRIA or NFIP for a Pandemic?

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Following terrorist events and viral outbreaks in the past 30 years, the insurance industry has laid the groundwork for what may evolve into a federally backed “Pandemic Insurance” program.

The Insurance Solution to Terrorism Risk

The Feb. 26, 1993, bombing of New York’s World Trade Center was undoubtedly a significant terrorist event. On that day, a 1,200-pound bomb exploded in the hotel garage below 2 World Trade Center. The bomb killed six people and injured more than 1,000. It also forced the evacuation of approximately 50,000 people. The bomb was placed there by a small group of terrorists tied to a Palestinian cleric.

The Sept. 11, 2001, attack on the World Trade Center and other U.S. targets was a similar terrorist event, but executed with the intent to have far greater consequences: 19 militants hijacked four airplanes, two of which were flown into the twin towers of the World Trade Center. Almost 3,000 people were killed.

The 1993 bombing, like the 2001 attacks, was covered by insurance: insurers paid losses for the 1993 bombing as well as for the 2001 terrorist attack. For the 1993 bombing, insurers paid over $500 million in losses. The insured losses for the 2001 attack were approximately $40 billion.

It was asked after the 1993 bombing—and again after the 2001 attack—why insurers paid out significant losses for an event that could have been excluded from coverage?

The answer in both instances can be found in actuarial science—the mathematical and statistical discipline that assesses risk in insurance. Fundamental to any analysis of risk is probability—insurers did not exclude terrorist events after the 1993 bombing because the likelihood of such an event occurring remained remote. Indeed, as noted above, the 1993 bombing was planned by a small group of terrorists, utilizing a simple strategy. By contrast, the events of 9/11 involved coordination by an established terrorist organization, methodical planning, and as the facts have shown, likely deliberate inaction or tacit support by foreign governments. The events of 9/11 caused insurers to reevaluate the probability of loss from a terrorist event because, as has been said, “the world changed” after 9/11: the possibility of coordinated attacks at multiple locations by sophisticated terrorists, with the aid of foreign organizations, significantly increased the potential for loss. Notably, prior to 9/11, coverage for losses arising from a terrorist event were typically included as part of commercial property coverage—with no separate premium attributable to the coverage.

Following the events of 9/11, as the potential for significant losses from terrorism became clear, insurers began to exclude coverage for such events. The consequences at that time for commercial real estate transactions, entertainment and sports events, were immediate: everything stood still. Thereafter, insurers worked in collaboration with legislators and policy experts to create the Terrorist Risk Insurance Act, or “TRIA,” which provided for insurer participation in loss events, and provided a Federal backstop for the most significant losses. Since 2001, and with data available from subsequent successful and attempted terrorist incidents, insurers have been able to gain greater confidence in underwriting such exposures. TRIA has enabled insurers to better manage their terrorism risk exposures. Also, as more exposure data has become available, insurers have developed sophisticated models. The result has been greater insurance capacity, lower premiums, and the participation by the Federal government as a backstop has been reduced.

The Pandemic Predicament

Just as the insurance response to terrorist acts was informed by actuarial analysis, so should core insurance principles inform the public policy discussions concerning potential insurance mechanisms for pandemics. The nature of pandemic risk compels consideration of two fundamental principles in underwriting insurance: risk aggregation and diversification.

In considering risk aggregation, diversification, and pandemics, we are again guided by history: according to the World Health Organization, Severe Acute Respiratory Syndrome (SARS) impacted 26 countries and resulted in more than 8,000 cases of infection during the 2002-2003 outbreak. Since that time, SARS reappeared four times, three times from laboratory accidents. It is understandable why, following SARS, insurers inserted communicable-disease exclusions in policies: underwriters analyze exposure by line of business, and look to limit exposure in such a manner that fewer lines of business will be affected by a single event. Pandemics can be expected to simultaneously impact property, liability, workers compensation, life and health insurance, among other lines, in multiple geographies across the world.

An Insurance Solution?

There have now been a number of legislative proposals, as well as some thoughtful analyses by industry leaders, outlining possible insurance mechanisms for a future pandemic. These proposals are largely intended to address the business interruption insurance aspect of a future pandemic event—the uncovered losses of small employers, industry, bars and restaurants having featured so prominently in the policy debates.

One of the proposed mechanisms is the Pandemic Risk Insurance Act of 2020, which is being considered by the House Financial Services Committee, and is built on the framework of TRIA. More recently, Lloyd’s and Chubb have issued draft papers outlining proposals. Lloyd’s suggestions are multi-faceted, and include some designed for SMEs, as well as a broader “Black Swan Re” structure providing commercial “nondamage” business interruption for future systemic risks. Chubb’s recent proposal has similar features to some of the Lloyd’s proposals, and advocates a “public-private” partnership built upon a TRIA-like structure—the premium charged by insurers would only be for the portion of the risk assumed. Under Chubb’s proposal, the most significant exposures would be borne by the US Treasury, like TRIA. As Chubb’s paper states, “this reflects the reality that only the government has sufficient resources to meet the full extent of pandemic loss, which is not insurable in the private sector.”

It is still early in the debate around insurance options for a pandemic event, and it would seem much more work remains to be done in order to further develop and fine-tune solutions. In the short term, particularly for small businesses, a mechanism built on the structure of the National Flood Insurance Program may be appropriate. With NFIP of course, the government is the de facto insurer; private insurers underwrite the coverage and adjust the losses but bear no risk.

Larger, well-capitalized businesses can look to purchase coverage from willing insurers, or look to self-insure, perhaps via a captive. To comply with Federal tax requirements, of course, captive insurance requires that the premium for the coverage is fairly priced—which can be a challenge given the limited data available and lack of a robust market for the coverage. One prominent insured that had coverage for the coronavirus, Wimbledon, has chosen not to renew because of the cost.

To recommend consideration of an NFIP-type structure—even for the short term—may seem to some as reckless: the program has been roundly criticized as flawed, inefficient, and wasteful of taxpayer funds—often helping those who do not need the coverage. Yet, the immediate challenge is whether one or more of the many solutions which have been offered will get traction in Congress and can be implemented quickly enough to provide some degree of assurance that small businesses can recover from a future pandemic. Anyone with experience lobbying Congress understands how difficult and uncertain the outcome. The utility of an NFIP-type structure is that it would be familiar to policymakers and could be implemented quickly. Also, the success of such a program would not depend on take-up from insurers, who would only administer the program, but assume no risk. A temporary salve, yes, but one to consider as we look for more permanent solutions that access private capital.

Despite the many constructive proposals to address pandemic risk, there is reason to question the willingness of underwriters to commit significant capacity to pandemic risk. As Lloyd’s has estimated, the underwriting losses from the pandemic are likely to reach $107 billion, making it the largest historical loss event.

Do insurers really have the appetite for more of these losses?
