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How Cos. Can Adapt To Insurance Industry After COVID-19

By **Daniel Struck** (June 8, 2020)

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The only certainty in our pandemic-challenged world is uncertainty. Will there be a vaccine and when? Will there be a second peak in coming weeks followed by a second wave in the fall? Will lost jobs return? Will economic recovery be uniform, sporadic or regional? Will remote work become the new normal for many workers? Uncertainty permeates every segment of society and the economy.

Insurance markets and the conditions of the business insurance market — terms, scope, underwriting requirements, pricing and capacity — are not immune to this systemic uncertainty. Business insureds normally look to insurance to provide certainty and a predictable means of transferring risk. But COVID-19 has and will continue to have a substantial impact on the insurance industry and on the expectations of insureds.

Anticipating the long-term impact on business insurance is difficult. It is clear, however, that the business insurance market will be turbulent following the pandemic. For business insureds this will be a period of uncertainty requiring diligence, a careful assessment of risk, and a thoughtful rebalancing of risk transfer and mitigation strategies.

Closures and disruptions in operations — resulting from governmental orders intended to limit the spread of COVID-19 and the resultant damage to health and property — have caused unprecedented losses to business. Industries such as restaurants, hospitality, tourism, entertainment and retail have seen income plummet.

Even industries that have been able to continue operations have seen disruptions to operations and supply chains. Insureds have looked to business income/interruption and related coverage grants such as governmental authority and contingent business income to cover some portion of their loss and extra expense.

Unsurprisingly, these claims have resulted in coverage disputes and litigation. Whether business income and related coverages apply to COVID-19 related losses will be a hotly disputed issue for the foreseeable future; but COVID-19 could well be the largest single casualty event ever.

In reaction to the looming coverage disputes, legislators in several states, including New York, Massachusetts and Ohio, have raised the possibility of legislation requiring insurers to cover business disruptions related to COVID-19 under existing business interruption coverage extensions. It is uncertain whether such legislation will come to pass.

But legislation compelling coverage for business interruption and other losses related to COVID-19 certainly would spawn court challenges. A more likely, but still speculative, legislative fix is the establishment of a pandemic-risk insurance program akin to the Terrorism Risk Insurance Act. However, it is not a foregone conclusion that such coverage would reach back to cover current losses. For many business insureds, a forward-looking TRIA-type program would provide no consolation for their current predicament.

The insurance-related fallout of the COVID-19 pandemic extends beyond first-party property insurance claims. Claims under directors and officers, employment practices, and cyber

policies, among other coverage lines, are inevitable in the aftermath of the pandemic. To date, there are around a dozen shareholder/securities suits alleging misrepresentations or other breaches of duty in connection with the pandemic.

In addition, D&O policies likely will be called upon to provide coverage for, among other things, governmental investigations, claims brought in connection with bankruptcy proceedings, and a wide range of alleged breaches of duty against private companies. Similarly, the mass layoffs, changes in working conditions, and, hopefully, returns to work associated with the crisis likely will result in claims impacting employment practices insurance policies.

With a substantial segment of the workforce now working remotely, there is fear that cybercriminals will exploit gaps in security to obtain access to personal or confidential information, to disseminate malicious software, and to engage in cyberextortion; each of which implicates cyberpolicies. Similar scenarios apply for other categories of insurance including fiduciary liability, errors and omissions liability coverages, general liability and other specialized coverages.

Even before the COVID-19 pandemic, insurance markets, including D&O and E&O, had begun tightening. This tightening of insurance markets manifests itself through more restrictive terms, more rigorous underwriting and stricter requirements for retaining or taking on new accounts, decreases in capacity and higher premiums.

Each of these approaches is a strategy for reducing and controlling risks for insurance companies. With the unsettled economic conditions brought on by the COVID-19 crisis, insurers are likely to adopt these strategies on a more widespread basis. These strategies have consequences for insureds.

Exclusions relating to damage or loss caused by or resulting from virus/bacteria or from biological pathogens already are widespread in the first-party property and general liability coverage lines. These exclusions are rare in other coverage lines, but in the wake of the COVID-19 pandemic, insurers may begin seeking to introduce these exclusions on a broader basis. If, as expected, the pandemic's economic fallout includes a wave of bankruptcies, insurers also may require bankruptcy or creditor-claim related exclusions for policyholders that they view as financially fragile.

The form and scope of any potential virus/bacteria, biological pathogen, or other exclusion that insurers attempt to impose will also have a significant impact on insureds. An exclusion that applies only to claims for injury caused by a pathogen arguably has a more limited impact than an exclusion that applies to claims "arising out of, resulting from or in any way relating to" injury caused by a pathogen.

The language of any such exclusion makes a difference. It remains to be seen whether insurers attempt to adopt industry-wide exclusions, or individual insurers adopt their own versions on a more limited basis to particular lines of coverage or for particular classes of insureds. It is unclear how much flexibility policyholders will have in resisting the introduction of such exclusions.

But if these exclusions are introduced, insureds should assess carefully the impact of such exclusions, should determine whether some insurers are offering alternate versions of the exclusion, and should carefully weigh their coverage options. Depending on the timing of the introduction of any such exclusions, insureds also should consider whether they have an opportunity to lock in coverage under current policies (particularly with claims made

policies) that contain more favorable terms.

Insurers also are likely to continue utilizing more rigorous underwriting practices and tighter requirements for retaining or taking on new customers. Already some insurers have started introducing COVID-19 related questions into applications — both for renewals and for new coverage.

These questions may ask about the impact of stay at home orders on operations; staffing actions taken as a result of stay at home orders; changes to the supply chain because of the pandemic; security measures taken to accommodate work from home; and the financial impact of closures, including on cash flow, revenues, income, liquidity and the ability to pay business debt.

Tighter underwriting requirements and less discretion to make exceptions are the likely byproducts of these inquiries. Tighter underwriting makes the renewal or application process more time-consuming and less predictable for insureds. Policyholders that could expect to be renewed routinely in previous years may finds themselves looking to secure new coverage in an environment in which insurers are less willing to take on new risks.

To respond to this situation, insureds and their advisers will need to plan more carefully for the application process, begin the process earlier than in the past, and be prepared to work harder to secure coverage.

Coupled with stricter underwriting, a tighter insurance market often means that insurers manage their exposures by writing lower limits or declining to participate at some layers of coverage. In this environment, insureds that were able to secure $10 million in limits for a primary coverage layer may find that only $5 million is available.

This is particularly the case for insureds that have suffered financial setbacks or are viewed as weakened due to the pandemic. Similarly, insurers may be reluctant to write new business or to fill gaps in coverage programs. With the unwillingness to add new capacity comes the risk that first-time buyers or insureds looking to secure new coverage may find that they have few good options.

Even before the pandemic, insureds were experiencing higher premium costs across multiple coverage lines. With the uncertainties in the economic conditions and the liability environment, policyholders likely will face substantial pricing pressure. For insureds that have faced dramatic declines in revenues, substantially higher premiums may result in difficult choices about the amount of insurance that they are able to buy, even as they are confronted with an uncertain risk environment. With higher pricing, insureds may need to reassess their coverage needs and risk tolerance.

The return to normal for insureds is likely to be far from normal. In the wake of the COVID-19 crisis, businesses are likely to face a challenging insurance environment. The disruptions of the last few months, the uncertain risk and liability environment, and economic uncertainty are all likely to result in the imposition of problematic policy terms and conditions, a difficult renewal and placement environment, reduced capacity, and increased premium prices.

In this market, insureds will need to work closely with experienced advisers, to be more deliberate and intentional in their risk planning, to take care to understand the potential impact of new coverage terms, and to pay greater attention than ever before to the process of securing insurance.

Daniel Struck is a partner and chair of the insurance practice at Culhane Meadows PLLC. The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

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