



COVID-19 Webinar Series

The Insurance Industry in the Time of COVID-19: Transactional Considerations and Regulatory Developments

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9:15 am – 9:45 am EDT
3:15 PM - 3:45 PM CEST

Overview

- The insurance sector in the pandemic-stricken landscape
 - coverage issues
 - operational issues
 - financial issues
 - reinsurance
- The way forward
 - variables to focus on in transactions
 - consequences for ART & ILS
 - impact on M&A

Views of the 2020 landscape

- As expected in late 2019
- As it appears today

2020 as expected in late 2019



2020 as it appears today



Coverage issues

- Business interruption
 - existing coverage: key terms, past litigation, litigation already in progress and legislative initiatives regarding existing coverage
 - legislation impacting future coverage (including PRIA, BICA and similar initiatives abroad)
- Event cancellation
- Liability (casualty) lines
 - D&O
 - general liability
- Health
- Workers comp

Coverage issues – BI

- Business interruption (BI) – existing coverage – key terms
 - policy wording
 - the traditional criterion in policy wording: “*direct physical loss or damage to property*”
 - references to civil authority orders
 - specific exclusions for losses arising from virus and bacteria exposure
 - some insurers may include exclusion in standard forms but offer fully underwritten and tailored coverage to clients upon request
 - burden of proof
 - coverage = insured
 - exclusion = insurer, although this can vary by jurisdiction and over time
 - keep in mind: “limitless imagination of the plaintiffs bar” (www.artemis.bm)

Coverage issues – BI

- Business interruption (BI) – existing coverage – past litigation
 - Pa. Supreme Court: Covid-19 is a valid basis for shutdown order since it is a “natural disaster”, which includes a “catastrophe which results in substantial damage to property, hardship, suffering or possible loss of life” (*Friends of DeVito v. Wolf*, No. 68 MM 2020 (Pa. Apr. 13, 2020) emphasis added)
 - Precedents reportedly include: air-borne asbestos fibers & toxic gases from defective drywall can constitute physical loss or damage for purposes of property insurance
 - The decision in a recent cyber coverage case held that loss of functionality can be embraced within physical loss. (*National Ink v. State Auto Property & Casualty Co.* No SAG-18-2138, 2020 WL 374460 (USDC, D. Md.; Jan 23, 2020))

Coverage issues – BI

- Business interruption (BI) – existing coverage – litigation already in progress (1/2)
 - Geragos*
 - Plaintiffs: closure order by mayor and governor fulfills the policy's physical damage condition because (among other things) “the deadly virus physically infects and stays on surfaces of objects or materials” and the scientific community, including the WHO, “has recognized that the Coronavirus is a cause of real physical loss and damage”
 - Insurer: there is no coverage because
 - » the policy requires “direct physical loss or damage” to property and this does not include the presence or suspected presence of a virus
 - » an exclusion provides: “we will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease”

* *Geragos & Geragos APC. v. The Travelers Indemnity Co. of Connecticut et al.*, case number 20STCV14022; Mark J. Geragos v. *The Travelers Indemnity Co. of Connecticut*, case number unavailable; in Superior Court of the State of California for Los Angeles County.

Coverage issues – BI

- Business interruption (BI) – existing coverage – litigation already in progress (2/2)
 - France: when BI coverage includes closure of restaurant by administrative order, does this include only closure for regulatory breach by the restaurant or general administrative closure order? Specific coverage of closures for epidemics are being honored
 - UK: BI coverage of “inability to use the venue due to restrictions imposed by a public authority following . . . an occurrence of a notifiable human disease” – insurer claims that only an “occurrence” at the insured premises is covered; further dispute concerns valuation of loss taking account of “any special circumstances or business trends” affecting the insured business, either before or after the loss
 - *Cajun Conti LLC, et al, d/b/a Oceana Grill v. Certain Underwriters at Lloyd’s of London and Governor John B. Edwards* (Louisiana)
 - *French Laundry Partners, LP d/b/a The French Laundry, et al., v. Hartford Fire Ins. Co.* (California)

Coverage issues – BI

- Business interruption (BI) – existing coverage – legislative initiatives
 - Bills in NY, NJ, Ohio, Mass., Penn. La., SC – e.g.
 - Any “provision of a policy . . . which allows the insurer to deny coverage based on a virus . . . shall be null and void. . .” (NY Assem. Bill 10226A)
 - Reactions
 - UK & French regulators: exclusions should be respected
 - » FCA: “no reasonable grounds to intervene in such circumstances” but where there is a clear obligation to pay out claims should be assessed and settled quickly
 - » ACPR: insurers’ assets cannot be used “to cover events which are specifically excluded from coverage”
 - NAIC opposition
 - Constitutionality issues
 - APCA statement; Chubb chairman/CEO: forcing insurers to pay uncovered BI loss would bankrupt the insurance industry

Coverage issues – BI

- Business interruption (BI) – legislation impacting future coverage (1/3)
 - Pandemic Risk Insurance Act (“PRIA”)
 - Insurers electing to participate in Federal reinsurance must make available coverage for public health emergencies that does not differ materially from the terms, amounts and other limitations for other perils
 - Insurers opt in each year to Federal reinsurance program; participating insurer pays an actuarially-based premium to Treasury
 - Trigger – \$[250,000,000] for all participating insurers; Cap – No Fed or insurer liability (if deductible is met) after aggregate losses exceed \$[500,000,000,000]
 - Insurer deductible = [5]% of preceding year's DPE; Federal share = 95% of insurer's losses xs deductible; Insurer share – Determined by Treasury Secretary
 - Insurer not liable for xs of {deductible + its share of insured losses}
 - Would invalidate existing pandemic exclusion, but (like TRIA for terrorism coverage and like BICA, see *infra*) would permit insurer to charge additional premium & reinstate exclusion if insurer notifies insured of rights and insured does not pay the additional premium

Coverage issues – BI

- Business interruption (BI) – legislation impacting future coverage (2/3)
 - Business Insurance Coverage Act - HR 6494 (“BICA”)
 - Insurer must make available
 - » viral pandemic
 - » forced closure
 - » mandatory evacuation
 - » any power shut-off conducted for public safety purposes
 - Coverage cannot differ materially from terms, amounts & other coverage limitations applicable for other kinds of coverage offered
 - Would invalidate existing pandemic exclusion, but (like TRIA and proposed PRIA) would permit insurer to charge additional premium & reinstate exclusion if insurer notifies insured of rights and insured does not pay the additional premium

Coverage issues – BI

- Business interruption (BI) – legislation impacting future coverage (3/3)
 - France:
 - creation of a government task force including legislators, key insurers and reinsurers and trade groups to report by early June on a backstop mechanism to permit coverage of high-impact risks to business turnover and continuity “at a reasonable cost for business and with government control”
 - endorsement by the regulator
 - UK: Association of British Insurers has raised the prospect of creating a state-backed system, similar to what exists for flooding, terrorism and earthquakes

Other lines affected by pandemic

- Event cancellation
 - Policy wording to be examined carefully
 - Dealing with hard cases – an example:
 - Policy wording excludes (since 2003) cancellations resulting from “severe acute respiratory syndrome-related coronavirus” – does that include “SARS-CoV-2” or “Covid-19”?
 - What is the impact of specifying in new wording including “SARS-CoV-2” or “Covid-19”?
 - If the coverage was bound in December and the premium (which paid via the broker) was received by the insurer in April (after lockdown was in effect), how should the insurer react?
 - When the insured threatens litigation and the insurer states publicly “we will carefully consider any comments or proposals made”, what result should be expected?
- Travel
- Trade credit

Coverage issues – Liability

- Liability coverage which may respond includes D&O and general liability
- Examples:
 - Claims against cruise line company for alleged misstatements regarding Covid-19 supposedly made
 - to customers regarding the danger of infection
 - in statements to investors about impact on the company's business
 - Claims against pharmaceutical company for alleged misstatements regarding prospects for developing an anti Covid-19 vaccine
- Other potential sources of liability include failure to protect employees or customers and breaches of privacy obligations

Coverage issues – Reinsurance

- Ex gratia payments
- Follow-the-fortunes/follow-the-settlements/cedent is sole judge
 - language varies, traditional formulations are not always present
 - follow-the-settlements presumes reasonable good-faith determination
 - how to deal with the examples on slide 15?
- Limits, attachment points and aggregation clauses

Operational issues

- Regulatory changes requiring acceptance of late premium payment
 - *E.g.* NY, “subject to consideration by the supt. of the liquidity and solvency of the applicable insurer” (Emergency Amdt. to 11 NYCRR 52, Apr. 7, 2020)
- Renewals – example from the FCA: for annual travel insurance, “if the claim arises after the renewal date, we would expect insurers to treat customers fairly, . . . This includes where the policyholder was given a reasonable expectation that cover would continue.”
- Compliance with conditions – another example from the FCA: for motor and homeowner’s insurance, “we expect . . . insurers not to reject claims because of a consumer’s understandable temporary change in how they use their vehicle and their home address.”

Financial issues – Changes in loss patterns

- Change in behavior impacts loss ratio
 - auto: reduced traffic → reduced accidents → windfall for insurers
 - other examples: reduced theft losses, airline hull
 - rebates/credits being granted in the US, France, UK and elsewhere
- Regulatory action – for example:
 - California – return of premiums (Bulletin 2020-3, Apr. 13) for private passenger auto, commercial auto, worker's compensation, commercial multi-peril, commercial liability, medical malpractice and any other line of coverage “where . . . risk [has] become substantially overstated”
- Spontaneous contribution of insurers to relief funds

Financial issues – Impact on balance sheet

- Dividend payments: regulators suggesting holdback but compliance is uneven
- Investment portfolios
- NAIC – interpretations adopted on April 15
 - Premiums > 90 days past due will still be admitted assets
 - For Q1 & Q2; sunsets Sept. 29, 2020 (INT 20-02)
 - Modified mortgage loan or bank loan that follows Fed govt.'s guidance – no TDR under SSAP No. 36
 - Ends earlier of Dec. 31, 2020/end of emergency + 60 days (INT 20-03)
 - May defer assessment of impairments for bank loans, mortgage loans & predominantly mortgage-based investments
 - For Q1 & Q2; sunsets prior to Q3 (INT 20-04)

The Way Forward



Variables to focus on in transactions – due diligence

- Standard issues for any target
- Issues particularly important for insurance/reinsurance deals include:
 - Financial, including capital adequacy, reserves, IBNR, assumptions
 - Risk management processes, approach and adequacy
 - Underwriting processes, personnel and approach
 - Business acquisition
 - Claims management and litigation
 - Reinsurance/retrocession
 - IT systems
 - Compliance and regulatory (AML/CFT, data protection, retained assets, etc.)
 - Expected evolution and synergies
- Issues specific to deals involving producers

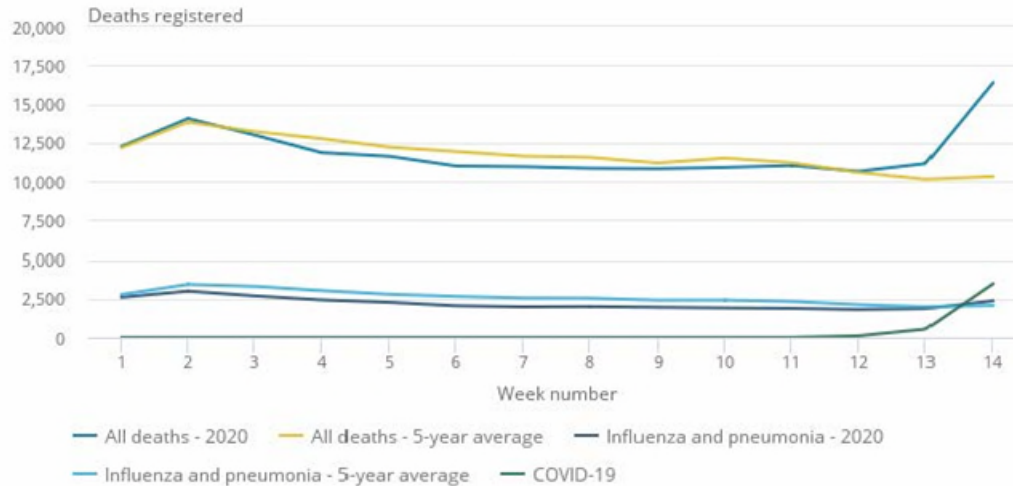
Variables to focus on in transactions – buyer protections

- Reps/warranties
 - Confirm full disclosure of COVID-19 related disruptions and related actions taken
 - Simplified example:

“Seller has complied with: . . . (x) all rules with respect to health and safety and obligations to its employees in respect thereof, including in connection with the advent of the COVID-19 pandemic; (y) all obligations under Laws adopted in response the COVID-19 pandemic including in respect of activities carried out during the containment period (as defined in . . .) and assistance it has received from any Government under such legislation; . . .”
- Insurance/reinsurance techniques to transfer or mitigate deal risk, such as:
 - Targeted portfolio transfer agreements
 - Reinsurance (e.g., XS per risk, XS per occurrence, stop-loss)

Consequences for ART & ILS

- Impact of the pandemic on mortality



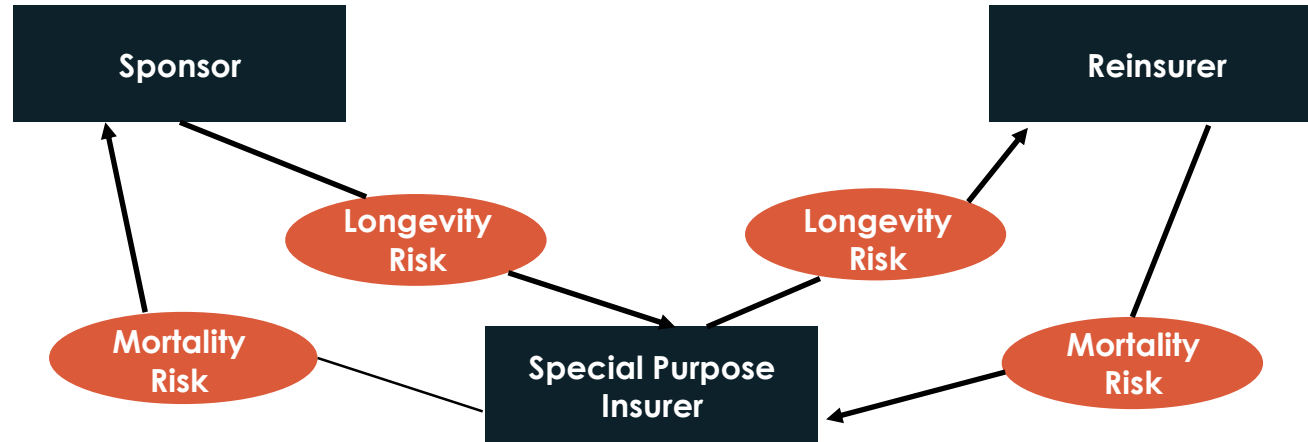
The number of deaths involving COVID-19 and "Influenza and Pneumonia" increased compared with the previous week – Number of deaths registered by week, England and Wales, 29 December 2019 to 3 April 2020 – Source: ONS

Consequences for ART & ILS

- Pandemic cat bonds
 - World Bank (IBRD) \$325M issuance
 - parametric (WHO) trigger: number of deaths, geographic distribution, spread across borders, growth rate
 - Class A \$225M at 6.9% with cap per occurrence
 - Class B \$95M at 1.5%
 - \$105M pandemic-linked swaps
 - Triggered April 17, 2020 for \$196M

Consequences for ART & ILS

Longevity/mortality trades



- Sponsor exposed to longevity risk enters into insurance contract with SPI
- SPI enters into back-to-back reinsurance agreement
- Periodic determinations of mortality experience of relevant population
- Sponsor is in “long” position on longevity of the population, Reinsurer is short
- Payments are netted as between Sponsor and Reinsurer on periodic basis

Impact on M&A

- Developments that might influence M&A and ILS activity
 - quantities of dry powder
 - general business prospects for the industry – uncertainty fosters need for protection
 - ILS as non-correlated investments
 - hard or soft market to come?

Thank you

Questions?

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