Countries Propose Catastrophe Insurance Through Public-Private Partnerships

By Vaasavi Unnava

Original post here.

On May 26, Congresswoman Caroyln Maloney introduced the Pandemic Risk Insurance Act of 2020 (PRIA). The PRIA would provide a framework for insurers to supply business interruption insurance to businesses affected by the COVID-19 pandemic. Insurance companies that choose to participate would offer pandemic coverage to businesses and, should aggregate insurance industry losses exceed $250 million, the federal government would cover most of the losses.

Business interruption insurance provides insurance for losses caused by natural disasters or catastrophes. In the context of the PRIA, insurers would provide business interruption insurance for pandemic-related losses. In addition to pandemic-related losses, the bill would also cover event cancellations, including awards shows, film and TV productions, and sporting events.

The structure of the PRIA would closely follow the Terrorism Risk Insurance Act of 2002 (TRIA), which was passed to make terrorism insurance available to businesses in the U.S. economy while protecting insurers' solvency. Like the TRIA, the PRIA federal backstop has an annual cap, though the PRIA's $750 billion cap far exceeds the TRIA's $100 billion.

Under the PRIA, insurers would pay a 5% deductible (measured as 5% of direct earned premiums from the previous year) before the federal government provides any aid for losses incurred from business interruption insurance policies. The TRIA has a 20% deductible. After the deductible is reached, the government would pay 95% of additional costs and the insurer would be responsible for a 5% copay; under the TRIA, the copay increased stepwise from 10% in the first year to 15% until ultimately setting a copay of 20%.

Participation in the PRIA would be voluntary. The TRIA required insurance companies to include terrorism insurance in all commerical policies for two years after the legislation passed.

The PRIA complements other proposals in the United States. Congressman Mike Thompson proposed the Business Interruption Insurance Coverage Act of 2020, which would require insurers to make business interruption insurance broadly available to businesses, though the bill has not progressed since its introduction in April. Industry groups have proposed the Business Continuity Protection Program (BCPP). The BCPP would allow businesses to purchase revenue replacement insurance from state-regulated insurance entities. The insurers would participate on a voluntary basis and funding would come from FEMA as a direct subsidy. Viral emergency declarations would automatically trigger payments. While some industry groups have put forth their own plan, others have endorsed the PRIA..

Similar to the PRIA, other legislative proposals around the world seek to revitalize or revamp frameworks used for catastrophe insurance funding. In the United Kingdom, the insurance industry is working with Pool Re, an insurance pool established in 1993 to act as a terrorism reinsurance fund. The British government established Pool Re to provide policy-level reinsurance to terrorism insurance policies through a government guaranteed reinsurance pool.

The program has faced criticism for its slow administration, its vulnerability to system-wide shocks, and tendency to crowd out private actors.

The Federation of European Risk Management proposed a similar public-private partnership for insurance companies in the European Union, which would specifically tailor contracts to cover events categorized as "non damage denial of access" events--where businesses have lost revenues due to denial of access to services rather than physical damage--similar to events covered under business interruption insurance in the United States. France is currently developing a series of proposals for a federal insurance backstop, which includes repurposing the structure of its existing public-private partnership for natural disasters called the Caisse Centrale de Reassurance (CCR). It has provided terrorism insurance since the terrorist attacks of 2001.

In April, economists Samuel Hanson, Jeremy Stein, Adi Sunderam, and Eric Zwick published a proposal suggesting the provision of "business continuity insurance" targeted to companies in the greatest need. The authors propose to evaluate need by utilizing income reporting from the previous year's tax documents to examine firm capital stock as well as industry-level shortfalls. Another proposal of theirs suggests providing low-cost junior subordinated loans to firms based on the same targeting metrics.

These proposals contrast with the World Bank Pandemic Emergency Financing Facility's catastrophe bonds, issued in July 2017. Catastrophe bonds are high-interest financial instruments that stop making payments to investors the moment a catastrophe happens. The World Bank's catastrophe bonds have faced criticism for their relatively low payout and high financing costs. In addition to other criteria like rolling case totals (rolling daily averages) and number of deaths, only an exponential growth rate of a coronavirus would trigger the bonds' payout; this year, global statistics met conditions to trigger halting interest payments for the bonds only on April 19, nearly 40 days after the WHO officially characterized COVID-19 as a pandemic.

Other attempts to hedge the systemic risk of a system-wide catastrophe include the creation of insurance-linked securities, such as sidecars. Sidecars cede premiums to investors with enough capital to ensure that claims are paid should they arise.