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Testimony of

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Urban Affairs Subcommittee on Securities, Insurance,
and Investment

Examining Frameworks to Address Future Pandemic Risk

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Subcommittee Chairman Menendez, Ranking Member Scott, and members of the Senate Banking Committee,

My name is Martin South and I am President of Marsh's United States and Canada Division. We have the privilege of providing insurance brokerage and advisory services to over 168,000 businesses, non-profit organizations, and public entities in the United States and Canada and being the insurance brokerage and risk advisory business of Marsh McLennan. Thank you for the opportunity to appear before you today to share Marsh McLennan's unique perspective on the need for a public-private partnership to insure pandemic risk.

As the world's leading professional services firm in the areas of risk, strategy, and people, Marsh McLennan has expertise in pandemic risk, dating back before COVID-19. We have a longstanding involvement with the World Economic Forum's annual *Global Risks Report*, which has long warned of the likelihood and potentially high impact of a global pandemic. In 2017, our company helped the World Bank structure the first-ever pandemic risk bonds. In 2018, Marsh developed an innovative insurance product, called PathogenRX, to provide pandemic business interruption coverage for key industries including aviation, construction, gaming, hospitality, retail, and tourism. In addition to helping clients through the current pandemic, we are also collaborating with international organizations to help mitigate the risk from vaccination programs for lower income countries and regions.

The COVID-19 pandemic has affected every one of us, personally and professionally. And while the pandemic is first and foremost a human tragedy, we are deeply concerned about its impact on the global economy and on our clients. Helping clients manage risk is our core business, and today we are here to give voice to them. I'd like to emphasize that point: Our role as an insurance broker is, first and foremost, to be an advocate for policyholders, our clients.

Pandemics are by definition global, which means that clients and insurers cannot diversify against them in the way that they might with catastrophe risks that are local or regional. And the stakes for policyholders regarding pandemic risk are high — this includes businesses of all sizes and in all sectors, educational institutions, non-profit organizations, public entities, and more.

Section One: A Global Perspective

With about 76,000 colleagues in over 130 countries, we bring to these discussions a global perspective from key economic sectors, including higher education, hospitality, healthcare, and energy, to name a few. Our specialists' professional knowledge of these industries, backed by Marsh McLennan's data, can be leveraged to help define new solutions for emerging and systemic risks.

The pandemic has reversed much of the economic progress made globally following the 2008 financial crisis.

Recent estimates from the International Monetary Fund (IMF) show that, in 2020, GDP fell by 3.3% globally and 3.5% in the US. The IMF projects that growth will rebound in 2021 and 2022. Still, output in many countries will remain below pre-COVID-19 projections into late 2022, according to the Organization for Economic Cooperation and Development (OECD). This year, Marsh co-sponsored with the OECD a conference that addressed the challenges and solutions regarding insurability of pandemic risk, and the potential role of public-private partnerships. A report based on the conference is included in our written remarks today.

According to the World Bank, the pandemic has pushed more than 100 million people into extreme poverty, and the number of people facing food insecurity has more than doubled. Three decades of progress against poverty are gone.

As the largest global insurance broker, our work with policyholders and insurers gives us a unique perspective into the role of insurance in a pandemic solution. Through the course of the COVID-19 pandemic, we have been engaged in discussions with about 40 governments globally.

There is clear interest in many regions for government involvement in solutions at the country, or even regional, level. This is especially the case in Europe, for example in France, Germany, and the UK. The European Commission is considering the feasibility of an EU-level solution. However, many countries are still grappling with third and fourth waves of COVID-19, which has meant that even some ongoing projects around establishing public-private partnerships have been put on hold until the pandemic recedes. That said, we expect conversations to continue in the near future, with support from many policyholder groups, insurers, and reinsurers to find a long-term solution.

Many governments — including in the US — have offered unprecedented financial support to businesses and their employees through wage subsidies, tax deferrals, and guarantees. But it has come at a heavy cost. By the end of 2020, debt-to-GDP ratios in OECD countries will have risen approximately 20% since 2019 — in many countries, reaching the highest debt levels in decades.

Moreover, despite this assistance, the cumulative effects of government lockdowns, social distancing requirements, and changes in consumer behavior have led to significant declines in revenue for businesses across multiple sectors. For some industries, the pandemic will have long-term implications.

Marsh serves clients of all sizes, including thousands of small and medium-sized enterprises. Policyholders from these smaller businesses have been heavily impacted by COVID-19 and they're vocal about the need for a long-term solution.

Section Two: Role of Insurance

Insurance plays a vital role in the US and global economies; without it businesses of all sizes, across industries, would be unable to start new ventures, hire new employees, or manage risk and grow to their full potential. The pandemic has created recovery and resilience challenges for businesses, governments, and insurers — issues that must be addressed to effectively manage a future pandemic. On the insurance side, we've seen over the last year that property and liability policies are severely limited in their ability to respond to pandemic-related losses.

Commercial insurance coverage typically responds to losses caused by natural catastrophes, such as earthquakes and hurricanes, and a range of business risks, from employee injuries to product liability and more. Although pandemics have occurred before, the economic impact of COVID-19 has been of a different magnitude, in part due to how interconnected people, businesses, and economies have become in the past few decades.

These interconnections facilitated the rapid, global spread of the virus in a relatively short time. And that, in turn, led governments and businesses alike to take actions to slow the spread. The ripple effects of doing so cascaded throughout companies, supply chains, and the global economy.

While some specialty insurance policies purchased before 2020 may include coverage for pandemic risk, most policies do not explicitly provide such coverage. Insurers, generally, hold the position that property, casualty, and other insurance policies are designed to cover losses suffered by individual insureds, but not for the aggregate economic impacts from a pandemic, such as extended lockdowns of large communities or entire countries.

Through the end of the second quarter of 2021 — about 16 months since the World Health Organization declared COVID-19 a pandemic — Marsh had received tens of thousands of pandemic-related claims notifications from clients around the world, including in the following coverage areas:

- **Property and business interruption** account for the majority of claims notifications with most in the UK and Ireland.
- **Workers' compensation** accounts for the second largest number of claims mostly from the US and Continental Europe.
- **Casualty**, apart from workers' compensation.
- **Travel/personal accident** notifications predominantly from the UK and Ireland.
- **Financial and professional** lines claims were the lowest type of claim submitted.

Section Three: Impact on the Availability and Affordability of Insurance

The magnitude of global economic losses, the difficulty in predicting what actions governments will take to contain infectious disease, and the potential for rapid, drastic changes in consumer demand make pandemic risk impossible for insurers and reinsurers to assume by themselves.

As you will see in the next infographic based on Marsh's data, COVID-19 has had a significant effect on the commercial markets (see Figure 1). Many insurers are now broadly excluding coverage for pandemic risk from their policies, and they're generally expected to continue doing so in the future.

But they have been paying out claims throughout the pandemic. Recent analysis by Artemis notes that COVID-19 losses and IBNR reserves reported by major insurance and reinsurance companies have risen significantly during the first quarter of 2021, with the total pandemic loss reported now nearing $38 billion.

Figure 1. How COVID-19 has impacted insurance markets.

COVID-19's Effect on Commercial Insurance Markets

Continuing uncertainty about global losses from COVID-19 is contributing to challenges for commercial insurance buyers. Through the end of the second quarter of 2021, Marsh received nearly 29,000 pandemic-related claims notifications from our clients around the world.

Driven by preexisting market factors and other trends, insurers continue to:

- Restrict capacity — the amount of coverage made available to policyholders — and raise prices.
- Exclude communicable disease coverage and tighten relevant policy language, terms, and conditions.
- Scrutinize risks in industries such as retail, healthcare, higher education, hospitality, restaurants, real estate, and public entity.

Property and Business Interruption

NEARLY **15K** **claims** reported by Marsh clients globally through June 2021.

Many claims are pending, and insurers are requiring extensive documentation — which is often lengthening the claims process.

Event Cancellation

MORE THAN **25%** **reduction** in market capacity over the last two years, accelerated by the pandemic.

8 leading insurers have exited the market since mid-2018 — including 5 since the pandemic began — with more departures expected.

Casualty/Workers' Compensation

24 **states** have introduced workers' compensation laws and regulations, including some that shift the burden of proof from employees to employers for claims in select occupations.

Although underwriting approaches differ, many liability insurers remain concerned about perceived third-party exposures associated with the pandemic.

Directors and Officers Liability

15% OR MORE **increase*** in pricing for public companies each month (March 2020 through May 2021).

Many insurers are narrowing coverage terms, including adding exclusions and taking away prior enhancements.

Employment Practices Liability

MORE THAN **2.7K** **employment suits** related to COVID-19 through June 2021.

With litigation and claims on the rise, many insurers are restricting capacity for certain risks.

A Public-Private Pandemic Risk Solution Is Needed NOW

Commercial insurers alone cannot fully provide businesses with pandemic risk protection. A public-private partnership can:

- Enhance market capacity and coverage.
- Create incentives for government, insurers, and businesses to mitigate pandemic risk.
- Build resilience to future pandemics.

To learn more, read Marsh's report on the need for a **pandemic risk protection solution**.

*Average year-over-year total program pricing changes recorded each month.

Sources: Marsh, Oliver Wyman, Fisher Phillips LLC.

Let me spend a few minutes looking at specific coverage areas and the impact the pandemic has had on them.

Property/Business Interruption

Perhaps the most contentious area of insurance related to the pandemic involves business interruption coverage, or BI coverage. This is typically one of the greatest areas of need for policyholders in a disaster. Put simply, this is the coverage that policyholders seek from their property insurance for financial losses incurred due to a natural disaster or a catastrophe such as a fire, a hurricane, or an earthquake.

Generally, property insurance policies are triggered by insured physical loss or damage. Since the pandemic began, many companies have filed first-party property and BI claims — most notably, due to business interruption caused by the action of a civil authority. Policyholders have argued that their BI policy language should respond to shutdowns and closures as mandated by several states and municipalities in the US, and other governmental authorities elsewhere.

A growing number of such claims are now the subject of litigation in various courts and countries. Through early June, approximately 1,500 COVID-19 coverage lawsuits were pending in US state and federal courts, according to a Marsh review of several sources, including the University of Pennsylvania's Covid Coverage Litigation Tracker.

To date, the results of these claims filings have varied:

- A relatively small number of claims — typically submitted by companies seeking recovery under specific sublimited coverage extensions — have been adjusted and paid.
- In some cases, insurers have issued reservation of rights letters, made requests for information to aid in their investigations, and proceeded with the measurement of claims.
- In other cases, insurers have denied claims due to absence of a physical damage trigger and the invocation of pollution/contamination and virus exclusions and other policy language.

General Liability and Umbrella/Excess

To date, general liability (GL) and umbrella/excess claims related to the pandemic — for example, alleging that a customer, client, or other third party was exposed to COVID-19 on an insured company's premises — have not been prevalent. In large part, this is due to the difficulty in definitively proving such exposure and that the company's negligence contributed to it.

That said, insurers have expressed some concern that casualty claims could develop in the future. Depending on the jurisdiction and the details of how a specific policy is written, litigation could potentially be filed as much as three years after the alleged exposure.

As a result, insurers have sought to add COVID-19 or communicable disease exclusions to their policies, particularly for insureds in hospitality and other select industries. In some industries — for example, restaurants — policyholders have been concerned that language proposed by insurers has been overly broad. They worry that it could be interpreted as restricting essential coverage for foodborne illnesses and other perils that would not have the widespread impact of a pandemic or epidemic. Marsh has generally made progress in amending such language.

Workers' Compensation

In March 2020, as the coronavirus was rapidly spreading, many insurers were concerned about its potential impact on workers' compensation.

More than a year into the pandemic, these initial worries have proven to be unfounded. The reality is that the average COVID-19 claim is for a lower amount than the typical workers' compensation claim. Moreover, COVID-19 claims have generally been clustered in a handful of industries, such as healthcare and food and beverage manufacturing.

The pandemic highlights how difficult it can be to determine compensability amid a public health crisis — mainly because individuals can be exposed both in the workplace and outside of it.

Amid this challenging environment, a number of states have taken action. As of early June, 24 states, along with the District of Columbia and Puerto Rico, have introduced laws and regulations dictating how workers' compensation coverage will respond to COVID-19 cases.

Workers' compensation capacity may be limited going forward for some types of employers, such as healthcare organizations and first responders. Employers in industries where employees often work in close quarters — for example, food and beverage manufacturing — may also face challenges.

Event Cancellation

Capacity for event cancellation insurance continues to decline. By our estimates, capacity has fallen more than 30% compared to before the pandemic. It appears that insurance market capacity will not return to pre-pandemic levels anytime soon.

Pricing for coverage has doubled or even tripled for some event cancellation buyers, while deductibles have increased by as much as 400% depending on the nature and location of the events to be insured.

Moreover, while communicable disease coverage was generally available — and affordable — before the pandemic, it is now widely unavailable and is expected to be extremely difficult to include in event cancellation policies going forward.

Management Liability

COVID-19 has compounded a number of challenges that were already mounting before the pandemic in directors and officers liability, commonly known as D&O, and in employment practices liability, or EPL. Financial pressures on insurers have been exacerbated by the pandemic, leading to significant increases in pricing over the last 15 months.

This is particularly the case for D&O, which has seen a 15% or higher increase, on average, in pricing since the pandemic began. In addition, many insurers are narrowing coverage terms.

As of early July, workers had filed nearly 2,800 COVID-19-related employment litigation suits in US federal and state courts, according to [Fisher Phillips' COVID-19 Employment Litigation Tracker.](#) Nearly a quarter of these have targeted healthcare entities.

To date, however, pandemic-related restrictions on D&O and EPL coverage have not been commonplace. Still, insurers are scrutinizing their risks and probing prospective insureds about their responses to COVID-19.

Section Four: Public-Private Partnership

The complex nature of pandemic risk means that we need strong, national pandemic management. This requires insurers, backed by the federal government, to write pandemic insurance policies and brokers to contribute our risk knowledge and infrastructure. Widespread pandemic coverage would see the insurance sector play an integral role in preparedness and resiliency ahead of future outbreaks.

Marsh McLennan has supported the development of numerous global public-private partnerships, so we have firsthand knowledge about how private capital can lead to smarter and better long-term outcomes when incorporated into a solution. Ultimately, we want to support the Committee in its quest to develop a workable solution for all policyholders.

The key to building a more proactive and agile response to the next pandemic will be an insurance and risk management partnership that helps facilitate coverage, aligns the needs of insurance buyers and insurers, and incentivizes preparedness, mitigation, and resilience.

Recent history provides examples of just how this has been accomplished in other areas. A range of risk-pooling models — from pure private partnerships to state-financed funds for non-insurable risks — can be used to address difficult risks (see Figure 2).

Figure 2. How a pandemic public-private partnership could be structured.

Private ← → Public

SEMI-PRIVATE POOLING REINSURANCE SCHEME

- Joint entity created by insurers to pool risk and share knowledge.
- Participation may be voluntary or legally mandated.
- Financing primarily provided by the private sector, with limited (if any) initial government financing and typically no committed reserve.

PUBLIC-PRIVATE PARTNERSHIP (PPP) REINSURANCE SCHEMES

- Structured risk sharing model between policyholders, insurers, and government.
- Government explicitly provides backing to the private sector to cap exposure and drive affordability.
- Participation may be voluntary or legally mandated.

PUBLIC FUNDS FOR NONINSURABLE RISKS

- Pure government setup, without any direct private involvement (other than aligning coverage).
- Fund is created with a reserve, built up over time, that can be used to pay out claims in the event of a pandemic.
- Claims against the fund should be aimed at covering risk events that cannot be covered by existing insurance offerings.

RELEVANT OPTIONS FOR MANAGING PANDEMIC RISK

Given their global nature, pandemics are unlikely to offer insurers and reinsurers any diversification. Some form of public support will likely be required to enable viable insurance and reinsurance markets.

That said, at Marsh McLennan, we believe that parts of pandemic risk are indeed insurable, but not without significant government support. The global nature and timing of pandemics means that there is not enough capacity in the industry to take on the risk *unless* there is a public-private partnership that engages the full credit and support provided by a government backstop.

Consider that there was about $910 billion of surplus in the insurance market at the end of 2020. But the surplus is largely committed to support other risks, while COVID-19 will end up costing in the trillions of dollars. However, the insurance industry's ability to take some level of risk, build surplus, handle claims, encourage risk mitigation and promote resilience can be of real value in a public-private solution.

Marsh is not promoting a specific solution. We are advocating for a public-private partnership that will accelerate economic recovery by leveraging the insurance expertise and infrastructure that is already in place to reduce uncertainty. We are advocating for a solution that allows insurers, reinsurers, and other capital providers to play a limited but valuable role. Insurance creates the right economic incentives to drive change in society.

There are many past examples of how governments and the private sector have come together to reduce risk and restore insurability, whether it be the establishment of fire brigades after the Great Fire of London of 1666 or the passage of the Terrorism Risk Insurance Act, and the creation of the Department of Homeland Security to coordinate security and intelligence responses to terrorism risk in the aftermath of September 11.

If we create the right economic incentives for insurers, policyholders, and the government, insurance can serve its traditional function of mitigating risk. Over time, the right risk program can spur new technologies, ways of working, services, insurance products, and processes to ultimately chip away at the enormous losses associated with pandemics. That, in turn, can help make pandemic risk more manageable and enable our economy to build the necessary resilience it needs for the future.

There is some optimism that improvements in preparedness and response could reduce the impact of future pandemics, and that the challenges to insurability of pandemic-related business interruption losses can ultimately be overcome.

As you can see in Figure 3, there are a number of existing risk pooling structures here in the US, and a variety of government-backed pools in other countries. At Marsh McLennan, we have been a party to the formation and ongoing support of most of these facilities around the world and understand the rationale as to why and how each of them have been structured and how they help policyholders.

Figure 3. What we can learn from current risk pooling models.

Key Learning	Selected Examples
Significant loss events or changes in how risks are modeled can lead to market-wide capacity withdrawal.	TRIA was passed in 2002 following a widespread withdrawal of commercial terrorism cover by reinsurers after the September 11, 2001, terrorist attacks. Flood Re was developed to provide affordable flood risk cover to the approximately 3% of UK homeowners living in high flood risk areas. Industrywide improvements in flood risk modeling had made coverage unaffordable for this cohort.
Extreme risks typically require some form of government backstop.	Government treasuries are the insurer of last resort on multiple loss sharing schemes. For example, the US National Flood Insurance Program (NFIP), the UK's Pool Re, and France's CCR Cat Nat and Gestion de l'Asurance et de la Réassurance des risques Attentats et actes de Terrorisme (GAREAT) have unlimited guarantees. TRIA, the Australian Reinsurance Pool Corporation (ARPC), Germany's Extremus, and the Netherlands' Nederlandse Herverzekeringsmaatschappij voor Terrorismeschaden (NHT) have limited guarantees.
Public-private partnerships provide credibility and can be structured to gradually shift risk to the private sector.	The US government's terrorism backstop enabled insurers to access affordable reinsurance for terrorism coverage. Over time, federal reinsurance participation in the program has fallen from 90% in 2002 to 80% in 2020, while insurer deductibles have risen from 7% of premium in 2002 to 20% in 2020. Insurer retentions have also increased, from $5 million in 2002 to $200 million in 2020. The UK government's backing of Pool Re similarly enabled insurers to access affordable terrorism reinsurance. Over time, the Pool Re fund grew and private reinsurer confidence was restored, to the point that £2.4 billion of reinsurance cover is now purchased. As a result, a loss fund of approximately £10 billion (including member retentions) sits between the consumer and the government needing to step in.
Programs can be used to incentivize the adoption of preventive measures.	Eligibility for the US flood risk program, NFIP, requires communities to adopt and enforce strict floodplain ordinances and offers premium discounts for outstanding performance. While there is no direct requirement for risk mitigation by Pool Re stakeholders, premium discounts of up to 7.5% are available for insureds that proactively undertake such initiatives. The US crop insurance industry supports continued agronomic research to determine how farmers can best incorporate risk management best practices in their operations and the impact those practices may have on insured crops. The US SAFETY Act of 2002 was created to spur the adoption of improved security measures by offering to limit liability of companies providing anti-terrorism products and services for qualified vendors. Similar policies, coupled with a robust public-private insurance market, could incentivize private sector adoption of prophylactic measures to drive down exposures. Flood Re is intended as a temporary solution to be phased out by 2039. As such, the government has committed to major investments in preventive measures, while Flood Re has prompted insurers to work to enhance their understanding, mapping, and modeling of flood risk and their collection of data for improved underwriting.

Conclusion

In summary, the high level of interconnectivity that defines the world today brings many benefits. However, it also sets the stage for more frequent epidemics and pandemics, which can have enormous social and economic consequences. If we fail to address the lessons learned from COVID-19 with regard to risk management and insurance, then businesses, non-profits, and public entities alike will have even less coverage available to them than prior to March 2020, and will be even more in need of government assistance in the next pandemic.

There is still much work to be done, and many people are still struggling with the ongoing effects of COVID-19. But there is also hope and optimism that we have reached a turning point.

As we continue to manage our way through the current pandemic, we need to prepare for the potential that another one will emerge. We need to help companies — our clients and others — plan an effective corporate response to future epidemics and pandemics.

The complexity of pandemic risk calls for close cooperation by the public and private sectors in managing its impacts. The key to building a more proactive and agile response to the next pandemic will be an insurance and risk management partnership with the government that helps facilitate coverage, aligns the desires of both insurers and policyholders, and requires mitigation practices. An efficient and effective pandemic insurance program will accelerate recovery and build resilience.

Appendix A

1. OECD: Addressing the Protection Gap for Pandemic Risk: Setting the Scene
2. OECD: Addressing the Protection Gap for Pandemic Risk: Finding a Way Forward – Conference Outcomes
3. Note: Marsh will be releasing a pandemic report in the coming weeks, and will send to the Committee once completed.