

Non-Concurrency Between Ceding Companies And Their Reinsurers For Communicable Disease Exclusions: The Next COVID-19 Shoe To Drop

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Body

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As COVID-19 continues to change our everyday way of life, its impact on the insurance/reinsurance industry also continues to develop. The reinsurance renewal process that many insurance companies recently went through exposes yet another impending issue the insurance industry will need to confront - non-concurrency between the coverage afforded by newly issued insurance policies and the reinsurance contracts protecting them.

The American Property Casualty Insurance Association ("APCIA") recently released a white paper that revealed that state regulators are often rejecting or delaying the approval of communicable disease exclusions while, at the same time, reinsurers are insisting that such exclusions are to be included in their reinsurance contracts.¹ Willis Re likewise issued a comprehensive report on the impact of COVID-19 that detailed the ways in which many reinsurers sought to add communicable disease exclusions to their reinsurance contracts, particularly where the underlying policy did not contain such an exclusion.² This potential non-concurrency in coverage could have far-reaching consequences on the insurance industry.

The essential purpose of reinsurance is to allow insureds to spread risk, thus decreasing exposure to catastrophic loss, reducing the risk of insurer insolvency, and ultimately allowing insurers to offer broader coverage at a fair level of premium. And one way to ensure this purpose is met is for reinsurance to be concurrent with the underlying policy (i.e., cover the same risks over the same time period). While parties can certainly negotiate for non-concurrency on certain risks, across the board non-concurrency between an insurer's policies and its reinsurance with respect to something as potentially catastrophic as communicable diseases, could present a host of prospective problems.

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First, requiring insurers to "go bare" on potential communicable disease losses (i.e., provide coverage for something not covered by reinsurance) could inflict a massive financial toll on the insurance industry. The financial impact of COVID-19 has been felt across the globe, in all industries great and small. And while the existence and scope of insurance coverage for COVID-19 claims is still very much in the air, the sheer magnitude of potential claims demonstrates the threat communicable diseases pose to the industry. This threat would be exponentially compounded were insurers required to pay these losses without the ability to recover from their reinsurers.

Second, insurers forced to potentially "go bare" on policies issued without communicable disease exclusions may instead simply choose not to write new policies in certain lines of business (or to write significantly fewer new policies). This reduction in carriers willing to offer new policies would reduce competition between insurers and potentially drive up premium costs for policyholders. It could also create a situation in which policyholders are unable to obtain insurance (at least in the amounts they may deem necessary) at any cost if insurers deem certain lines of business as being too risky without a communicable disease exclusion.

Third, the "forced" non-concurrence that results from state regulators rejecting the use of communicable disease exclusions while reinsurers are requiring same will likely lead to a sharp increase in disputes. While reinsurers will insist they are not required to cover these claims, insurers, relying on the doctrines of follow the settlements/fortunes may take a different view. Regardless of the outcome of these disputes, the adversarial nature of the process, conducted on what would likely be a massive scale, would dramatically alter what is supposed to be a relationship based on utmost good faith.

It seems that every day COVID-19 affects the insurance industry in new and different ways. State regulators' rejection of insurer's efforts to protect themselves from these (and similar) losses by use of communicable disease exclusions, coupled with reinsurers requiring the very same exclusions to be included in their reinsurance contracts, has created a "forced" non-concurrence between insurance policies and the reinsurance backing them. And while this non-concurrence may only be the latest issue for the insurance industry to address, it is one with widespread implications, and the potential to cause fundamental harm to the industry.

Endnotes

1. See Communicable Disease Exclusions: Maintaining Stability in Property Casualty Insurance Markets Amid a Global Pandemic, Co-authored by Dr. Robert Hartwig and APCIA available at http://www.pciaa.net/docs/default-source/default-document-library/cd_exclusion_whitepaper.pdf

2. See Moving on from the initial assessment phase of COVID-19, a Willis Re Impact Report, available at <https://www.willistowerswatson.com/en-US/Insights/2020/04/covid-19-willis-re-impact-report>.

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