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Navigating the Impact of COVID-19 on Small Commercial Businesses and Insurance Companies, and a Call to Action for Future Communicable Disease Outbreaks

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Navigating the Impact of COVID-19 on Small Commercial Businesses and Insurance Companies, and a Call to Action for Future Communicable Disease Outbreaks

by

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Abstract

The short-term and long-term effects of Covid-19 have caused many small commercial businesses to face financial hardships, loss of employees, and even closures for entities that were already experiencing low profit margins. Distraught with their businesses suffering, owners turned to their primary insurance companies to receive compensation through their business interruption policies. However, most insureds were upset when they discovered that their insurance plans did not include communicable diseases and pandemics as a covered peril. This led to many small businesses battling these issues in the courts and fighting for insurance companies to provide financial assistance to them during this tragic time. This paper provides an overview of the insurance industry and describes the formation of small businesses. The relationship between small commercial entities and the pandemic will be described and analyzed. It will then provide background information on existing government insurance programs, and will conclude with a call to action for the government and insurance companies to be prepared for the next communicable disease outbreak.

Introduction

The consequences of Covid-19 have caused many small businesses to suffer from financial hardships, loss of employees, and temporary and/or permanent closures. Business owners went to their primary insurance carriers in hopes of recovering their lost income through their business interruption policies. However, they soon discovered that their insurance plans did not include communicable diseases and pandemics as a covered peril. This led to many small businesses battling these issues in the courts and fighting for insurers to provide financial assistance to them during this tragic time. This paper provides background information and facts about the insurance industry and describes the formation of small businesses. The relationship between small commercial entities and the Covid-19 pandemic will be described and analyzed. It will then provide information on the history of government insurance programs and describe three existing programs, and will conclude with a call to action for the government and insurance companies to be prepared for the next communicable disease outbreak.

Background Information

When businesses plan ahead for potential risks or risks they are currently facing, they can practice risk financing by purchasing different types of insurance. There are four key benefits in utilizing insurance for a business, with the first being that owners no longer need to pay for losses that their organization will, or are, suffering from as long as the characteristics of the loss are deemed acceptable under their policies. The second advantage of insurance is that uncertainty for the business is reduced, since insureds do not need to worry about having volatile cash flows from paying out their own losses. Another benefit to purchasing insurance is that the premiums paid are tax-deductible because it is considered a business expense. The last key advantage is that most carriers will provide other risk management services to their customers. For instance, if a small business files a property damage claim after a telephone pole damages their roof, the owner would not only benefit from having the roof repaired but also from having a risk engineer, a claims representative, and/or a contractor share their knowledge and expertise with them.

Though purchasing insurance for a business has proven to be a valuable asset for businesses, there are some drawbacks to this risk financing method. Despite the fact that premiums are considered tax-deductible, is can sometimes be a large up-front cost that is different for each owner, depending on the characteristics of their business. With all business characteristics constant, an owner of a retail store in Corpus Christi, TX would pay a higher premium than an owner in San Antonio, TX because the Corpus Christi store is located closer to the coast and therefore poses as a higher risk for insurance companies to take on. Because insurers have their own risk appetites, they expect their insureds to pay a higher premium if they want the carrier to provide coverage for them. Regardless of differences in premium prices, insurance poses as a large expense for all businesses, which can lead to owners feeling hesitant to invest in it. Another disadvantage to purchasing insurance is that it could potentially lead to less loss control practiced by the owner and the employees of a business. Employees might start to practice morale hazard, as they will no longer feel the need to be as careful with their operations and actions because of the existence of the insurance. The last key disadvantage to insurance is that negotiating contracts is costly and takes a significant amount of time and effort to secure the appropriate coverages.

The Formation of the Insurance Industry. As most scholars and historians do, it is significant to look at the roots of a topic in order to ensure that unwanted history does not repeat itself. In the case of the insurance industry, people must analyze how it came to be and understand the struggles it faced in order to appreciate it.

The very first type of insurance transaction to exist was known as the bottomry. Used by merchants in Babylon, Hindus, and Greeks, bottomry contracts were essential in the formation of marine insurance in the 15th century (Greene). These contracts allowed for ship owners to borrow money from lenders, and was used for repairing and equipping ships (Britannica, bottomry). In exchange, “the interest [collected] on the loan[s] covered the insurance risk” of financing the ships (Greene). If the ship became lost at sea, then the lender would lose their money and it would instead be used to pay out the losses of the ship and the cargo onboard (Greene). Bottomry contracts, which soon became popular “in Ancient Greece and other maritime nations that were in commercial contact with [them]” acted as the first financial instrument to transfer risks from one party to another (Greene). However, this was not the only contract to form around marine insurance in Europe.

In 1688, *Edward Lloyd’s Coffee House* was known for providing information about ships to patrons (Lloyd's, Corporate History). In the coffee houses, merchants would post physical documents on the walls that listed information about different ships. It then had space for specific patrons, who would soon be identified as underwriters, to “accept insurance on ships for the payment of a premium” (Britannica, Lloyd's). In 1774, the underwriters reorganized and gradually “moved their operations to the royal exchange,” an existing property and liability insurance corporation in the United Kingdom (Britannica, Lloyd's). Today, *Lloyd’s* is its own separate insurance market that acts as a major reinsurer, but also offers primary insurance products (Greene). They are known for taking on unusual risks that most insurance carriers would not insure, such as the beards of forty members of the Derbyshire Whiskers Club and the legs of Betty Grable (Lloyd's, Innovation and Unusual Risks).

The formation of the insurance industry in the United States was not as fast-paced as that of Europe's. In 1752, Benjamin Franklin established the *Philadelphia Contributionship*, the first American insurance company (Greene). Seven years later, the first American life insurance company, the *Presbyterian Ministers' Fund*, was created. As insurance began to flourish and America became independent from Great Britain, the country began to notice that the industry was far from perfect. A lot of the "early property insurance companies failed from speculative investments, poor management, and inadequate distribution systems" (Greene). Natural disasters, such as the Great Chicago fire of 1871 and the San Francisco earthquake of 1906 also led to the failure of many U.S. insurers (Greene). After the U.S. Civil War, insurance companies noticed that "dividends [that] were declared…had not been earned, reserves were inadequate, advertising claims were exaggerated, and office buildings were erected that sometimes cost more than the total assets of the companies" (Greene). However, beginning in 1920, the life insurance sector experienced a steady growth and since then has utilized data-collecting skills and past experiences to learn what to look out for when insuring customers (Greene). Since these hardships, U.S. insurance companies have developed and learned from these experiences. They can now use the knowledge gained from these experiences to continue to grow and flourish, as they provide customers with the financial assistance they need.

Since its start in the 18^{th} century, the U.S. insurance industry has flourished in many ways. Specifically in the P&C sector, many companies of different sizes have been formed to ensure that every customer has access to the financial resources they need. Companies such as *Progressive Insurance Group* (*PRG*) and *Travelers Group* (*TRV*) are examples of leading insurance carriers in the P&C category. In addition, in 2020 the industry as a whole collected $1.28 trillion in net written premium, with the P&C branch responsible for 51%, totaling to

$652.8 billion (Institute). According to the U.S. Department of Labor, 2.9 million Americans reported to have worked in the insurance industry in 2020 (Institute). In response to Covid-19, insurers donated about $280 million to combat the effects of the virus (Institute). As time progresses, society continues to learn and grow; it is up to the insurance industry to keep up with society in order for the world to continue to be creative and flourish without becoming significantly risk averse.

Small Commercial Businesses. In a time when large corporations are dominating the market, small businesses continue to emerge and flourish in local communities. To help with this growth, government organizations such as the *U.S. Small Business Administration* (*SBA*) have been established "to aid, counsel, assist, and protect the interests of small business concerns," as well as promote entrepreneurship (SBA, Organization). The history and formation of small businesses in the U.S. prove that though they struggle more than major corporations, they have served as the backbone of entrepreneurship and innovation in our society.

Some of the first American small commercial businesses date back to the 17th century, when America was not yet fully discovered. At this time, Americans would barter by "trading crops, supplies, and services" to each other; this acted as their temporary economic system until their independence from Great Britain in 1776 (Square, History of American Small Business). Shortly after the country gained freedom, small businesses and the monetary system in the United States began to boom (Square, History of American Small Business). In the 1800's, small commercial businesses would continue to barter but introduced a new concept to our economic society that still exists to this day. When customers did not have attractive goods and/or services to offer the owners, they would add credit to their name with the use of credit coins or charge plates (Square, History of American Small Business). Since then, the use of money as a form of payment for goods or services has been, and continues to be, practiced today. Despite the noted success and growth of small businesses in the U.S., they have also experienced hardships that larger corporations have not.

In the 1960's, towards the conclusion of the Baby Boom, small businesses were challenged with keeping up with a growing corporate America. They were given difficult tasks, had unrealistic expectations to uphold, and were expected to survive and thrive despite the fact that large corporations were dominating the market. In fact, small commercial business owners found their lives to be more difficult "by the power of organized labor, by the impact of government requirements, rules and regulations, and by [their] ability to secure the type of financing to provide stability" for their organizations (Shils). Because most of these businesses were single enterprises, partnerships, or smaller corporations, they depended "more on direct labor [and] ha[d] less capital investment[s]" than the leading larger companies at the time (Shils). In addition to these challenges, small businesses were also expected to keep the U.S. unemployment rate down. With a massive increase in population arising from the Baby Boom, it was expected of small businesses to hire "young [people] without skill" because the "hiring criteria and standards [for these organizations were] less professionalized" than they were for major corporations (Shils). Despite these obstacles, small commercial entities dominated the market with a total of 4 million small businesses in the United States at that time, which made up around 95% of all businesses in the country (Shils).

Today, small businesses play a huge role in the development of local communities and the U.S. economy as a whole. From implementing environmental, social and governance (ESG) methods into their practices to sponsoring neighborhood students in their high school extracurricular activities, these businesses have changed the way American consumers and government officials view business. Since the 1960's, the government has stepped in to create organizations needed to help owners flourish and grow their operations. The *SBA* provides financial counseling, exercises, and services to small business owners that wish to receive help on how to manage their organization. They, along with *American Express*, are also responsible for the implementation of *Small Business Saturdays*, which are days "to celebrate and support small businesses and all they do for their communities" (SBA, Small Business Saturday). In addition, companies such as *Square* have been created to make small commercial business practices simpler. One of the financial products they offer owners are small business loans "that give eligible businesses…access to funding" (Square, Why Square). The struggles that these owners have faced and continue to face today are slowly being compensated with access to government help and support from companies that aim to assist them.

Despite the help given to these owners, they still run the risk of facing unknown and unprecedented challenges that might arise. Whether it was mentally, financially, physically, or politically, no one was prepared for a pandemic to completely disrupt our daily ways of conducting business and life. When Covid-19 hit the U.S. in March 2020, all business owners were left to face this dilemma with no background knowledge and no plans.

Covid-19 and Small Commercial Businesses

Covid-19 impacted not only people, but many businesses as well. Workers and consumers were afraid to travel, be inside facilities, interact with others, and partake in their usual day-to-day activities. In addition, many cities, counties, and states imposed mandatory "shelter-at-home" orders, where people were forced to remain in their homes (with some exceptions) to reduce Covid-19 contamination (Strain).

Places such as restaurants and salons that have always relied on the physical presence of their customers faced "a permanent revenue loss from [the] long shutdown" (Strain). In addition, even prior to the pandemic, most of those places "operate[d] with low profit margins, [which made] it difficult to absorb… large decline[s] in revenue sustained over several months," such as the one caused by Covid-19. (Strain). One thing that almost all small businesses had in common in early 2020 was that they began to go through a chain of unwanted and devastating events. They noticed a decrease in customers present in their buildings due to the shelter-at-home orders and customer fear, which led to a decrease in revenue. Eventually, many employees were either terminated by their employers or quit their jobs due to a decrease in salary or fear to go out in public. Finally, when a business had no other resources to rely on, they were left with no other choice but to shut down their operations and close temporarily, and in some cases permanently.

Though the Covid-19 era has been difficult for many business owners, many of them did not go down without a fight. Many had assistance from volunteers, donations, and the *Paycheck Protection Program* (*PPP*). In addition, some businesses altered their operations to minimize losses, with one example being restaurants opting for delivery and take-out options. Another resource that owners reached out to for help was their insurance carriers. However, the application of certain policies and their coverages was not as black and white as it may have seemed. Many insureds were shocked to learn that their policies did not cover their needs arising out of the pandemic. Overall, small business owners were desperate for assistance, and when their insurers could not offer them protection, they sought to learn why.

Communicable Diseases and Insurance. When a business shops around for insurance packages, they have the ability to purchase different policies depending on their unique needs.

One of these types of insurance, business interruption insurance, is different than most because it covers lost income rather than damages or legal expenses.

Business interruption, also called business disruption insurance or business income insurance, "is intended to protect businesses against income losses sustained as a result of disruptions to their operations after a disaster. It provides relief for damages caused by the closing of a business facility and the cost of rebuilding a business after a disaster" (Neophytou). Every business is different, so owners have the ability to customize this policy to fit their exact needs. However, it is generally assumed that, regardless of customization, all business interruption policies will cover the "revenue lost due to closure; fixed expenses, such as rent and utility costs; [and] expenses of operating from a temporary location" (Neophytou). If a business owner feels the need to add extra protection, they might have the opportunity to add endorsements and additional coverages to their policy.

For most claims reported by small businesses during the Covid-19 pandemic, insureds assumed that their insurers would pay out their losses through their business interruption insurance plans. However, this was not the case for most of them, as they began to notice that their claims were being rejected by their insurance carriers. While the name "business interruption" implies that losses arising from an interruption to a business' operations are covered, the language within the policy itself shows that communicable diseases, such as Covid-19, are not a covered peril. Despite the fact that the Covid-19 pandemic caused many small commercial businesses to temporarily shut down operations, most business interruption policies did, and still do, not consider it a covered cause of loss. This is because most business interruption insurance policies are intended to protect businesses against losses "caused by physical damages to…property, which, for many businesses affected by the coronavirus pandemic, ha[d] not been the case" (Neophytou). Although damages to a building caused by a fire and the temporary location change to continue operations would be covered, the income lost from the shutdown of physical buildings due to the pandemic were not.

The only ways for a small business owner to have been covered for losses due to Covid-19 was for them to have purchased an additional add-on to their business interruption insurance before the pandemic occurred. This coverage, known as contingent business interruption (CBI) coverage, "specifically includes the loss of revenue caused by a communicable disease outbreak" as something they would pay out to insureds (Neophytou). The *International Risk Management Institute* states that this insurance "is an extension to other insurance, [such as business interruption], that reimburses profits and extra expenses resulting from an interruption of business at the premises of a customer or supplier" (Torpey). Together, these two definitions indicate that CBI coverage can protect small businesses from losses in revenue, profit, and other expenses due to interruptions from customers and/or suppliers.

Small commercial business owners have the opportunity to shop around for their ideal CBI coverage and business interruption policies. The key thing they must do is to ensure that the policy they choose "specifically includes any disasters they may [expect to or currently] experience, including communicable diseases" such as Covid-19 (O'Donnell). Because they provide advantageous benefits, these policies are "typically subject to a maximum payout and can be costly" (O'Donnell). Though CBI coverage can provide owners with the help needed if suffering from the social and economic consequences of a pandemic, it is only helpful if purchased before a communicable disease outbreak. Therefore, any small business that tried to get this coverage after March 2020 was unable to receive it, and had to undergo the financial hardships themselves.

Many small commercial business owners did not have the necessary coverage needed to remain profitable during the pandemic. When they assumed that their business interruption insurance policies would protect them, they were shocked when their carriers rejected their claims.

Court Cases and Their Verdicts. When most small commercial businesses did not receive the help they desired from their insurance carriers, some took the insurers to the court room to let a judge interpret the policy. This did not just apply to the United States; insurers worldwide began to notice that their customers were unhappy and willing to battle things legally.

In the U.S., many businesses reported property claims to their insurers, hoping that their property policies, which for some customers include business interruption coverage, would provide them with the financial support needed to remain in business. The big question for the courts was, and still is, whether "the coronavirus circulating in the community, landing on surfaces [and] being carried around by infected people result[s] in property damage" (Bischoff). At first, one would most likely come to the conclusion that because Covid-19 did not result in any physical damages to the building or personal property of these businesses, insurers were not responsible for activating their customers' property coverages. One specific state that dealt with a great number of court cases was Ohio. Dean Fadel, a member of the *Ohio Insurance Institute*, stated that a decision in favor of the policyholders would "literally wipe out the entire industry in a matter of months," as insurers would be forced to pay out all claims from businesses that had shut down due to Covid-19 (Bischoff).

The Supreme Court in the United Kingdom was another court that had to struggle to answer whether small businesses should have their Covid-19 claims paid out by insurers. According to *The Institute of Chartered Accountants in England and Wales*, insurance companies "refused to pay small business claims" that were caused by the Covid-19 pandemic or the mandatory quarantine measures (Wales). They stated that they were not able to activate their business interruption coverages because communicable diseases were not listed as a covered peril (Wales). Therefore, insurers did not believe that they could provide assistance to their customers. The "High Court judges ruled in favor of the arguments…by the FCA [Financial Conduct Authority] on the majority of the issues" (Wales). When a "comprehensive agreement" was not reached, "leapfrog" appeals were taken by insurers and the FCA (Wales). These appeals allowed for them to pass the Court of Appeals and report directly to the Supreme Court. In the end, the Supreme Court ruled in favor of the policyholders, which resulted in ensuring that all claims reported by small businesses be paid out (Wales). In total, this court ruling resulted in the U.K. insurance industry paying out over £1 billion (Wales).

Primary insurance carriers worldwide struggle to pay out claims for lost income reported from their small business customers because the losses are too large for them to take on. Government insurance programs are great resources to assist insurers in mitigating the financial severity of these risks.

An Analysis of Government Insurance Programs

When a risk possesses potentially severe consequences, most insurance companies do not want to cover the losses associated with it. Government insurance programs were created as a way for insurers to transfer these risks, as well as decrease their severity.

Kenneth Arrow, a renowned American economist and theorist, discovered two leading reasons why private insurance markets did not provide insurance to certain risks. The major cause of this issue was the potential for an increase in adverse selection (Priest). According to this situation, people with higher-than-average chances of loss will tend to seek insurance at standard rates rather than rates adjusted specifically towards them. The effects are a cyclical chain of events, starting with insurance companies gaining a greater proportion of bad-risk individuals compared to the population, which leads to higher financial losses and premiums. Because of this, customers considered “good risks” leave their insurers due to the increase in rates, and then the insurance pool contains an even higher proportion of bad-risk people. Eventually, private markets for insuring a certain risk may cease to function at all because the financial implications of adverse selection are too severe. The other reason Arrow identified as to why private insurance companies did not provide coverage to certain risks was due to the inability to control moral hazards (Priest). The private market was unsuccessful in combating the effects of moral hazard for certain types of insurance, and they eventually decided to stop providing insurance for these losses.

After studying the private market and realizing that health insurance markets were “incomplete,” meaning that protection against non-ideal risks was undesirable for them to insure, Arrow introduced the idea of government involvement (Priest). He suggested that in order for this model to work, one assumption must be met, and a fact must be recognized. First, it must be assumed that every consumer aims to maximize expected utility and is risk averse (Priest). People aim to increase their personal satisfaction to the best of their ability while taking on minimal-to-no risks, or paying more than expected value to remove the risk. The mathematical fact that Arrow refers to states that the larger the population of taxpayers is, the smaller the risk that is borne by each taxpayer (Priest). With these in mind, Arrow concluded that the government should provide funding for large, unideal losses when private insurance companies cannot (Priest).

Not only did he promote government assistance, he suggested that this new insurance be compulsory. Although this combatted the negative consequences of adverse selection, this made way for a new dilemma: low-risk customers were forced to comply with this program and were trapped in this insurance pool, subsidizing the high-risk customers (Priest). Despite this, Arrow believed that the net “gains to the high-risk [individuals] are greater than the losses to the low-risk [individuals]” (Priest). Because of his contribution, several government programs have been established in order to fund catastrophic, large, and unideal losses.

Before diving into descriptions of different government programs, it is important to know some of the requirements that ideal insurable risks possess. First, the probability of a loss has to have a low likelihood of occurring and a high severity, meaning that although the risk leads to a large financial loss, it rarely occurs. This ties into the second requirement, which states that the loss must be potentially large. The third rule is that the loss must have been accidental or unintentional from the insured’s perspective. Fourth, the loss must be determinable and measurable, indicating that it is easy for a claims representative to analyze the damages quantitatively. Fifth, the risk must not be subject to catastrophic loss, meaning that loss exposures should be independent of one another. Finally, following the Law of Large Numbers, the risk must have a vast number of similar exposure units. In applying these requirements, it is clear that communicable diseases such as Covid-19 are not categorized as ideal insurable risks because they subject to catastrophic losses.

Terrorism Risk Insurance Act (TRIA). Prior to the September 11th, 2001 terror attacks in the United States, terrorism insurance was “normally included in commercial insurance policies” (Webel). Despite the fact that risks associated with terrorist attacks usually possess large consequences, the likelihood of them occurring prior to September 11th, 2001 was perceived to be low. Because of this, insurance companies felt safe providing coverage for these types of losses because they knew that they would not have to frequently pay them out. The September 11th, 2001 terrorist attack caused insurers to rethink the ways they provided coverage for these types of events.

The destruction of the World Trade Center's Twin Towers not only caused physical ruins, but financial ruin as well. Businesses that surrounded the area suffered from property damage, long periods of business interruption, and workers' compensation claims. In total, there were more than $40 billion worth of claims reported and paid (Cilluffo, Cardash and Magarik). In response to this data, many insurance and reinsurance companies stopped providing terrorism coverage for their commercial policyholders (Webel). Worried about the financial state of the economy and businesses in New York, President Bush signed Public Law 107-297, otherwise known as *TRIA*, in 2002 (Cilluffo, Cardash and Magarik).

TRIA ensured that insurers offered "terrorism coverage to their commercial policy holders and provide[d] a federal backstop to the insurance industry," meaning that the Department of the Treasury had "to provide short-term [funding] to the private insurance market" (Cilluffo, Cardash and Magarik). Since it's start, it has been renewed multiple times in the past two decades, and is now titled the *Terrorism Risk Insurance Program*, or *TRIP*. However, since its official launch in 2002, the program has faced several changes besides its title. These adjustments are: "the program trigger, [which is] an aggregate annual minimum loss threshold below which no government loss-sharing occurs; the federal share of insured losses; the insurer deductible, [which is]…based on each insurer's premium volume; and the insurer aggregate retention amount, the losses retained by insurers if post-attack recoupment occurs"

(Webel). The government will continue to provide funding for potential terrorist attacks until *TRIP*'s expiration in 2027.

National Flood Insurance Program (NFIP) Certain natural catastrophes, such as floods, are not an ideal risk for insurance companies to provide coverage for because of their catastrophic nature. In addition, the consequences of these catastrophes are often extremely large losses for insurers and insureds that suffer from property damage. The key issue is that floods create highly correlated exposures, so when one insured has a loss, there will be many other insureds in the same location that have the same loss. It is because of this that insurance companies are hesitant to provide flood coverage to their customers.

In the 1960's, the federal government noticed the lack of action from insurers to sell insurance which covers losses arising from floods. Furthermore, these companies were not able to diversify their customers due to their lack of data on where these storms were most frequent (Nechamen). Because insurers did not have this information and continued to provide coverage in these areas, adverse selection from businesses that were in the high-flood regions was present. To combat this situation, the government launched the *National Flood Insurance Program*, or *NFIP*, in 1968, which made "flood insurance available for homes and businesses across the United States" (Nechamen).

The program works in a way that is similar to a deal. In short, "the federal government…provide[s] for federally backed flood insurance if a local community agree[s] to manage development in flood prone areas" so that the consequences of the storms would not be as severe (Nechamen). William Nechamen describes it as a three legged approach: flood insurance covers losses in flood-prone areas, flood maps are created over time to show the areas where floods are most frequent, and local communities manage development of new buildings in those areas (Nechamen).

Some commercial insurance companies offer flood insurance through *NFIP*, such as *The Hartford Financial Services Group, Inc*. Depending on the business, the quote may reflect different guidelines and prices. However, "the maximum coverage for flood insurance is $500,000 for both building and personal property" regardless of the loss faced (The Hartford). Insurers that provide coverage for losses arising from floods utilize the *NFIP* to offer assistance to their insureds when their properties are damaged by floods.

Fair Access to Insurance Requirements (FAIR) plans As mentioned, certain characteristics of a loss can make it unattractive to insurers. In the 1960s, the federal government noticed that a large population of individuals were being denied homeowners insurance due to the location and state of their dwelling. These houses are considered high risk, which means, according to the government, that "it has a greater likelihood of… homeowners insurance claims" than other properties and homes across the country (Coleman). Features that can deteriorate the value of a home for insurers are the age, location, vacancy, and the number of previous claims filed (Coleman). Insurance carriers did not want to pay out large and frequent losses for houses that are high risk. It is because of this that the government established *Fair Access to Insurance Requirements* (*FAIR*) plans to offer homeowners insurance for these dwellings.

The *FAIR* plans act as a residual market "where taxpayers and private insurance companies fund the costs" because the insureds have been previously rejected by private insurers (Coleman). Under the plans, coverage is provided for fires, windstorms, vandalism, and riots, but fewer perils would be included than what would normally be covered by a regular homeowners policy (Coleman). In addition, depending on the location of the house, the policy might include liability coverage and/or additional perils coverage (Coleman).

To showcase the differences of *FAIR* plans according to the state, the *Texas FAIR Plans Association* (*TFPA*) will be described and analyzed. Established in 1995, the *TFPA* has been providing homeowners insurance to many homes in the state of Texas. The first policy was issued in 2002 and there are over 71,000 policies in force to this day (Association). The mission of FAIR plans is essentially to provide insurance policies for houses that are high risks, regardless of their location, age, and vacancy. TFPA "provide[s] essential residential property insurance products and services for eligible Texas policyholders when no one else will" (Association). Contrasting to why FAIR plans were initially established, TFPA came into play "to address insurance availability problems resulting from the mold crisis" that caused severe water and mold damage to many homes in Texas (Association). When Texas insurers noticed many claims coming in due to the crisis, they remodeled their underwriting policy to reject applications that were impacted by this event. FAIR plans mandated all states, Texas included, to provide homeowners insurance to any and all houses that suffered damage from the mold crisis. In order to obtain this government insurance, a customer would have to call their local Texas independent agent and meet criteria specified by the Texas legislature (Association).

Taking Action for Future Potential Outbreaks

The Covid-19 pandemic has caused much destruction to society. From the permanent shutting down of businesses to altering the way individuals conducted their daily routines, everything came to a halt as scientists worked quickly to learn about and find a vaccine for the virus. After reviewing the relationships between Covid-19 and insurance for small commercial businesses, it is clear that there was a lot of gray area in terms of policy navigation and acceptable coverages. When the U.S. government noticed a fast decline in the number of small businesses that were operating throughout the pandemic, they stepped in to provide whatever financial assistance they could.

Paycheck Protection Program. While the pandemic was growing in the U.S., the *Coronavirus Aid, Relief, and Economic Securities* (*CARES*) *Act* was passed on March 27, 2020 to provide "fast and direct economic aid to the American people negatively impacted by the COVID-19 pandemic" (Education). Part of the *CARES* act was the *Paycheck Protection Program* (*PPP*), which acted as a government insurance product. The *PPP* "keeps workers attached to their employers and…ensure[s] small business continuity" by offering loans to business owners (Strain). The loans would be taken out from a commercial bank, and would total "up to 2.5 times [the business'] average monthly payroll costs, not…exceed[ing] $10 million" (Strain). Whatever money from the lender was used during an eight-week period to keep business operations afloat was forgiven and converted into a grant, with the only requirement being that the small business owner does not fire their employees or reduce their paycheck (Strain).

To better understand the implications of the *PPP*, it can be analyzed using Kenneth Arrow's two criterion for government interference. His first criteria is to assume that every consumer aims to maximize their expected utility and is risk averse (Priest). Covid-19 struck fear, sorrow, and worry across the nation because no one expected it to damage society as much as it did. In addition, there was no concrete and formal data about the virus. Therefore, it is assumed that Americans were risk averse throughout the pandemic. In terms of maximizing expected utility, many small business owners faced uncertainty regarding the future of their establishments, and did their best to continue operating and remain profitable. Arrow's second criteria is the mathematical fact that the larger the population of taxpayers is, the smaller the risk that is borne by each taxpayer (Priest). Despite the fact that many deaths occurred throughout the Covid-19 pandemic, this fact remained true.

Unfortunately, because the *PPP* was launched in such a rush, there were flaws in the program. A while after the program was created, the *U.S. Treasury Department* and the *SBA* mandated that 75% of all *PPP* loans that were forgiven be utilized for payroll only (Strain). To many small business owners, this was considered an unrealistic expectation. To combat this requirement, owners would "misrepresent themselves on their applications" and lenders would look the other way (Strain). Because the program was new and the *Treasury Department* was not enforcing their requirement, lenders were convinced that they would not be held responsible for allowing fudged applications to qualify for loans (Strain). This unethical behavior that was practiced led to certain local businesses that relied on government help and acted ethically to go unrecognized, and it also opened the door for moral hazard once owners began lying on their loan applications.

Review, Implement, and Educate. When Covid-19 was at its worst, society was not familiar with it and its impact. Now that two years have almost passed since the beginning of the pandemic, scholarly and medical research has been conducted to better understand it. After reviewing the battles of insurance carriers and small business owners, in addition to obtaining a better understanding of government-mandated insurance programs, I propose three simple yet effective solutions that must be implemented before another pandemic causes destruction to our society again.

First, a thorough and formal review of the *PPP* must be done to spot additional flaws and errors. Though it provided significant financial assistance to small businesses across the country, it left room for moral hazard to be present. Analyzing the program and its weaknesses will allow for a more structured, stricter, and equal system where any small business can receive the loan amounts they need. Second, the government should consider implementing mandated programs that have been proposed to mitigate the large losses caused by pandemics. The *Pandemic Risk Insurance Act* (*PRIA*) would have ensured that the government pay "95% of insurers' pandemic-related claims," in exchange for primary carriers joining the program (Goldsmith). However, the act has been rejected by insurance companies because pandemic risks are not ideal and insurable (Goldsmith). Before the next outbreak occurs, the government should critique appropriate government-mandated insurance proposals, such as *PRIA*, for necessary revisions to make it attractive to primary insurance carriers, and then implement said programs to reduce the financial severity of future losses arising from viruses. Finally, it is clear that most small commercial business owners that had insurance did not know that their business interruption policies could not cover their lost income. If they had invested in CBI coverage or additional add-ons to their business interruption insurance, then they would have been covered. Therefore, the final solution to help mitigate future potential losses against a communicable disease outbreak is to mandate insurance carriers to educate their customers about any endorsements or policies that could protect them from these losses. This will not only avoid future court cases and large legal expenses, but will also allow for small business owners to learn more about risk management and their own policies.

Covid-19 sparked a global revolution; it has modified the way individuals conduct their lives, receive healthcare, and conduct business operations. During the Covid-19 pandemic, small commercial businesses suffered significantly from reductions in revenue, decreases in customers and employees physically present, and temporary and/or permanent shutdowns. Business owners thought they could utilize their primary insurance carrier to pay out lost income, but for many that was simply not the case. The *PPP* provided financial help to these owners when their insurance companies would not, but the program was flawed and left room for unethical practices to be performed. After studying research that has been conducted since the start of the pandemic, it is clear that the three solutions described in this paper will not only benefit small business owners, but will allow for a flourishing economy and healthier society if another communicable disease outbreak occurs. It is time for the U.S., our government, our small commercial business owners, and our consumers to be active, rather than reactive for the next pandemic.

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