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US Government Shutdown: Key Risk and Insurance Considerations

The current US government shutdown — which has set a record for the longest shutdown in US history — began on December 22, 2018 and remains ongoing as of this writing. Amid the uncertainty of how long it will last, businesses are facing a number of challenges, and the risks grow each day.

With no end in sight, organizations should keep tabs on what is happening and how they are affected. And risk professionals should consider whether and how the shutdown could affect their organizations' operations, revenues, and risk profiles and whether various forms of insurance coverage could respond.

In the following pages, Marsh specialists share their views on the implications of the shutdown on various risk areas and industries.

Property

Non-physical damage business interruption (NBDI) products are likely to address claims of business income loss that could be attributed to the shutdown. However, NBDI policies are written on a standalone basis and few companies purchase such coverage.

Traditional property insurance, however, is unlikely to cover business interruption stemming from the government shutdown because such policies are generally triggered by physical damage; government action on budget issues is typically not covered as it does not involve PD. Moreover, as the government shutdown is now a known potential loss, businesses cannot currently purchase coverage for it under a more specific NDBI policy.

Flood risk: Authorization for the National Flood Insurance Program (NFIP) lapsed when the government shut down on December 22, but the program was reauthorized and funded shortly thereafter. The NFIP has essentially been back to normal operations since December 28.

Security and emergency response: The Federal Emergency Management Agency's (FEMA) response to any natural disasters that occur during the shutdown could be slowed. The government's partial closure could also affect the speed at which businesses recover following catastrophes, although it is unlikely to have an impact on underlying property insurance coverage. While we are optimistic that FEMA and other US government agencies will remain responsive in case of regional and national catastrophes, a rapidly developing disaster could catch FEMA off guard and make it difficult to quickly recall furloughed employees.

Casualty

Since the Department of Labor is funded through September 2019, the Occupational Safety and Health Administration and Mine Health and Safety Administration are continuing to operate. The Centers for Medicare and Medicaid Services (CMS) is also fully operational, which means that Medicare set-asides should continue to be processed.

Workers' compensation: Some federal contractors, as well as companies that are large suppliers to the federal government, might lay off or furlough staff during the shutdown. These measures can generally lead to a rise in workers' compensation costs stemming from an increase in the frequency of questionable claims. Another potentially costly scenario is that workers with accepted claims may pursue previously delayed surgery or other treatment, which might cause some medical-only claims to become lost-time claims. Instituting claims-handling controls that focus on thorough investigations could help employers reduce the potential increased frequency of questionable claims. For example, investigators should seek to obtain formal statements from both employees and employers — and possibly others — to verify whether accidents have taken place.

If the shutdown stretches on, the impacts on workers' compensation could worsen. Workers' compensation insurers, for example, could see adverse effects on premiums due to missing payrolls. If this is accompanied by a surge in claim frequency, there is a risk of an increase in expected loss ratios, which could, in turn, lead to insurers attempting to increase workers' compensation rates.

Liability considerations: The shutdown could force companies to alter their operations, which could change their risk profiles, leading to a potential for liability-related issues. Employers should take stock of any changes in their operations and work with their insurance brokers, risk management resources, and legal counsel to understand how existing insurance might respond to these changes, and determine if they need additional coverage to account for any changes in their risk profile.

Directors and Officers Liability

With the Securities and Exchange Commission (SEC) partially closed, enforcement activities have presumably been curtailed. For example, the SEC's Office of the Whistleblower is unable to review tips and complaints sent via mail and fax during the shutdown. Its website, however, directs those with time-sensitive or critical tips and complaints to submit them electronically.

SEC reviews of filings for initial public offerings are also being delayed. Companies seeking to go public immediately can file registration statements during the shutdown, but that could invite enforcement actions or investor litigation if the SEC identifies deficiencies in disclosure statements once agency reviews resume.

The Department of Justice (DOJ) and Federal Trade Commission, meanwhile, are continuing to review merger and acquisition applications for antitrust concerns, but such reviews will likely take additional time during the shutdown.

Organizations that generate significant revenues or funding from the federal government could also face shareholder litigation, particularly if they have allegedly misrepresented to investors the significant of government-generated business on their cash flows.

These effects could trigger litigation and other claims alleging breach of fiduciary duty and other failings, and thus serve as an important reminder for businesses to consider the adequacy of their directors and officers liability insurance policy limits.

Employment Practices Liability and Wage and Hour

The Equal Employment Opportunity Commission (EEOC) is currently closed due to the government closure. During the shutdown, EEOC charges cannot be filed via the agency's online portal, and employers that had charges filed against them prior to the shutdown cannot access information about those cases. The agency also cannot file litigation during the shutdown and may be forced to file for continuances of litigation that was already underway before December 22.

Federal government contractors and other businesses that depend on revenue from the federal government may find the need to furlough or lay off employees as a result of the shutdown, which could lead to claims under the Worker Adjustment and Retraining Notification (WARN) Act. The law requires most employers with 100 or more employees to provide notification 60 calendar days in advance of plant closings and mass layoffs. Federal, state, and local government entities, however, are generally not subject to the WARN Act. And most employment practices liability (EPL) insurance policies exclude coverage for WARN Act claims, except for a small subset of policies that provide limited defense expense coverage. To the extent that federal government-dependent businesses separate employees due to reduced revenue, they might also face wrongful termination and discrimination claims, depending on the circumstances of the employees' departure and whether they are members of classes that enjoy legal protection from discrimination.

Employees — including some at federal agencies — who have completed work or provided services but have not received payments due to the shutdown could file wage and hour claims, which may trigger coverage under the dedicated wage and hour insurance coverage now available in the marketplace. Employers have increasingly elected to purchase these policies since they were first made available approximately six years ago. Wage and hour claims are generally excluded from EPL policies.

EPL policies could, however, respond in the event that employees file retaliation claims against employers that take adverse employment actions against workers who participate in politically-tinged social media conversations about the shutdown.

Environmental

The US Environmental Protection Agency (EPA) is operating with a reduced workforce and has halted a number of inspections, although employees who were not furloughed are responding to emergencies to safeguard human life or the protection of property.

The agency's databases, and its website, are not being updated, which means that property transactions — including mergers and acquisitions — could be delayed if environmental consultants are not able to obtain needed technical information from the federal government to support ASTM due diligence requirements. Since due diligence assessments tend to be used to underwrite environmental insurance policies that support these transactions, insurers could impose coverage caveats on certain conditions until the appropriate data can be secured and evaluated. Transactions as well as operations may be affected due to delays in the issuance of EPA settlements or "covenant not to sue" agreements.

Due to the shutdown, the EPA is currently not responding to queries for approval of cleanup activities and is not reviewing risk assessment or work plans. This could be particularly problematic since environmental insurance policies typically stipulate that most remediation expenses must be pre-approved by insurers, meaning that any new expenses or changes must be reported immediately. Pollution legal liability policies often include a government-mandate trigger stipulating that cleanup must be required by the governing regulatory body. Thus, if a site falls under the jurisdiction of a federal agency, cleanup approval could be deferred, causing delays in claims adjustment. These delays could lead to site deterioration, leaving parties with little choice but to proceed with remediation activities without the EPA's approval.

Political Risk

The Overseas Private Investment Corporation (OPIC) remains partially operational, with the agency providing service on existing political risk insurance policies as it normally would. OPIC, however, is not currently writing new political risk insurance policies. During the shutdown, organizations should be able to obtain political risk insurance coverage via private insurance markets.

Trade Credit

The shutdown will not likely affect the trade credit insurance market or cause events that will trigger trade credit policies. Organizations that act as suppliers to the federal government, or otherwise depend on it for revenue, could suffer financial consequences from an extended shutdown. But trade credit policies often have claim waiting periods of 60 to 90 days before coverage is triggered. Policies with such waiting periods will thus only respond if the shutdown continues through late February or beyond.

Marine Cargo and Logistics

Several government agencies with oversight of cross-border shipments — including US Customs and Border Protection, the Office of Foreign Assets Control, and the Food and Drug Administration (FDA) — are trying to keep essential operations running. But the longer the shutdown lasts, the more likely it is that a lack of funding and staffing will take their toll. For cargo shippers, logistics companies, and those that they serve, the net result may be delays in the transportation of goods arriving from outside of the US and additional costs, including for deterioration, detention, and demurrage.

Cargo insurance policies generally do not respond well to losses associated with the effects of government shutdowns. One reason is that such policies are generally only triggered in the event of fortuitous losses. As the potential for a shutdown and its effects are well-known and have been anticipated for some time, it may be difficult for a policyholder to argue that the shutdown consequences triggered a fortuitous loss. In addition, cargo policies typically offer limited coverage for damage resulting from delays. As such, cargo shippers and others face a difficult choice of either shipping goods and risking delays and potential spoilage or holding back shipments for the duration of the shutdown and risking the loss of business.

Industry Effects

Education

Although a bill to fund the Department of Education was signed into law before the shutdown, higher education institutions could still be affected by the ongoing closure. Financing for research is a major challenge since a number of funding agencies are effectively closed. Colleges and universities can encounter reputational and/or litigation risks if they are forced to interrupt clinical research programs due to stoppage of federal funds, leading to affected patients seeking to hold institutions responsible for interruption in treatment. Contractual obligations to these patients will likely remain in place even when federal funding is suspended, and the question of whether insurance will respond to such litigation is largely untested. Thus, institutions should carefully review their contractual obligations with both patients and corporate partners and calculate the effect of the shutdown on their cash flows. It is imperative to keep detailed records that can be used in the event of litigation or required for insurance claims. The potential closure of laboratories could put specific biomedical science research at risk if tissue/cell samples are compromised, leading to an adverse impact on findings.

The length of time that the shutdown continues will determine how higher education institutions are ultimately affected. Challenges can arise if students and faculty members are unable to obtain or renew their student and work visas. While US Citizenship and Immigration Services is fee-funded and should continue processing visa requests, there could be delays if the agency requires support from other entities affected by the shutdown. Since foreign students can represent up to 30% of a US college or university's tuition base, a prolonged shutdown that delays visas could also affect an institution's revenue. It is important for institutions to track their reliance on foreign tuition and arrival and departure timelines for students already on campus or waiting to enter the country.

Food and Beverage

Some critical US Department of Agriculture operations, including meat, poultry, and egg inspections, are continuing during the shutdown. FDA food safety inspections have been halted since workers have been furloughed. Nevertheless, food and beverage production continues, which could lead to concerns among consumers about the safety of edible products on store shelves and in restaurants while the government is shut down.

Food and beverage companies should continue following good manufacturing practices during production and abide by all applicable regulatory requirements, including recordkeeping and internal testing, just as they would during normal government operations. Food and beverage companies might consider stressing through social media and other channels that they are devoting the same resources to food safety as they would normally.

The shutdown could also lead to direct and indirect revenue losses for some food and beverage companies, including restaurants and other companies with locations in national parks and federally funded museums, food and beverage suppliers with government contracts, and those that serve areas with heavy government worker populations, such as Washington, DC. Although parametric insurance policies could theoretically provide coverage for such losses, traditional property and other policies will generally not respond.

Finally, the lack of availability of the Department of Homeland Security's E-Verify will likely affect employers across several industries that rely on it to hire workers, but it may be especially painful for food and beverage companies given the industry's high turnover. During the shutdown, employers can still hire workers, but neither employers nor employees can resolve tentative nonconfirmations (TNCs) sent prior to the shutdown. Food and beverage employers should consider the potential legal consequences of taking adverse action against employees with TNCs during the shutdown and prepare for delays in E-Verify case proceedings once the shutdown ends and agencies work to clear their backlogs.

Health Care

Major health programs — including the Affordable Care Act (ACA), Medicare, and Medicaid — are funded through September and there are no immediate fears of hospitals shutting down due to the current impasse. Public health surveillance — for example, The Centers for Disease Control's tracking of currently climbing influenza rates — is also protected, as is major influenza research overseen by the National Institutes of Health.

However, health care has not been left untouched by the partial government closure. The DOJ has requested an extension in an ongoing lawsuit to defend the ACA since lawyers cannot meet the filing deadline due to the shutdown. Meanwhile, visa applications for foreign health care workers may be delayed, while CMS paperwork may see processing delays. Another issue could revolve around contract workers not getting paid. With the federal government being the largest purchaser of health care services, worker absenteeism could lead to shutdowns and delays if the current situation is prolonged.

Life Sciences

A number of Department of Health and Human Services (HHS) employees have been furloughed, including more than 40% of those working at the FDA, one of the main regulators of life sciences companies. And with dwindling funds, the FDA is being forced to make decisions to focus its resources on key consumer protection functions, including shifting user fees from pre-market drug reviews to focus on post-market safety surveillance. But since the FDA is unable to accept new user fees, these funds are at risk of running out if the shutdown persists.

Until the shutdown ends, the FDA cannot accept new drug applications, pre-market approval applications, and others. And while reviews funded by user fees will carry on, the process is likely to take longer and the slowdown is expected to continue after the shutdown ends. Since the FDA is not operating at full capacity, life sciences companies that received warning letters or are operating under a consent decree, can, in the meantime, try to remediate and carry out inspection readiness activities.

Manufacturing

The ongoing shutdown could have significant ramifications for manufacturers that rely heavily on government contracts. Slowing payments to military suppliers, defense contractors, and others could be frustrating, leading to delayed payments, production disruptions, and layoffs.

For manufacturers experiencing disruptions and the loss of income, business interruption (BI) and contingent business interruption (CBI) coverage is unlikely to be triggered because those policies typically require property or physical damage.

Public Entity

The shutdown has led to uncertainty about federal funding for transportation projects, which could affect road construction or other maintenance carried out by state and local governments. Any stoppages of planned works could compromise the safety of roads and bridges, putting the government at risk of litigation and other claims related to road accidents.

Additionally, national parks and other federal properties could face security issues, including potential injuries to visitors, due to an absence of staff that would ordinary deter and respond. Property insurance policies could respond in the event of physical damage due to security issues. However, the federal government retains full immunity from liability. And state statutes differ, with some extending full sovereign immunity to public entity properties and others maintaining a tort cap limiting the value of liability per claimant.

Real Estate and Hospitality

The partial government shutdown could adversely affect both the housing market and the real estate industry. A major concern surrounds the thousands of low-income tenants facing eviction as expired contracts cannot be renewed. Also worrying is the potential delay in processing new mortgages and fears that landlords of public housing and furloughed federal workers miss mortgage payments. Moreover, the shutdown, especially an extended one, could create unease about large investments.

The Department for Housing and Urban Development, which is responsible for the Federal Housing Administration, has furloughed 95% of its employees. While the agency is still providing some services, a slowdown is expected, including in Federal Housing Administration loan approvals.

The hospitality industry is also feeling an impact with some hotels in Washington, DC, Virginia, California, and elsewhere seeing significant drops in occupancy as government travel is curtailed. These losses are unlikely to be covered by insurance.

Transportation

Several agencies involved in border control, such as the FDA, are affected by the ongoing shutdown, meaning that trucks crossing US borders with Canada and Mexico might experience delays. Any losses are unlikely to be covered by insurance.

The partial government closure is also having an effect on investigations into auto defects and consumer complaints run by the Highway Traffic Safety Administration. However, since the user-fee supported Highway Trust Fund, which funds most infrastructure projects, is not affected by the shutdown, work is expected to continue on federal-aid highways. And while a third of Department of Transportation employees have been furloughed, the Federal Motor Carrier Safety Administration is still operating. Roadside truck inspections managed by state agencies, meanwhile, will continue.

Lessons Learned

The current shutdown is not the first time the federal government has ground to a partial halt and unfortunately it's unlikely to be the last. It is thus important for companies to have plans in place to anticipate and mitigate the effects of any upcoming government shutdowns. While completely avoiding the impact may not be possible, having contingency plans in place can help reduce risks and allow for operations to continue with limited financial impact.

In managing the current shutdown and planning for future shutdowns, organizations should consider:

- Developing a thorough business resiliency plan that specifically addresses government shutdowns. This plan, which should be part of an enterprise/strategic risk management program, should also evaluate any issues related to employee benefits as well as layoffs or furloughs due to a reduction in work.
- Determining how reliant your business is on US government contracts and considering whether to reduce that level of reliance.
- Looking closely at both your supply chain and your vendors, both local and international, and calculating the impact of a government shutdown on them.
- Reviewing your current insurance policies and work with your broker and risk management resources to identify gaps related to business interruption and other coverage. Examine your policies to determine whether they would cover the effects of a shutdown, and speak with your broker about potential coverage additions that might help to mitigate the impact of a shutdown.
- Carefully analyzing your company's human resources policies on furloughs and layoffs, and putting resources in place to discuss these issues with employees and outline the company's plans to help them during a shutdown. Proactive outreach can help reduce, or altogether avoid, fraudulent claims, including workers' compensation claims that tend to increase following mass layoffs.
- Evaluate whether your overseas operations could be affected by the local political climate.

While the repercussions of a partial government closure should be limited in the short term, the longer the shutdown extends, the more likely companies will start feeling the impact. It is therefore imperative to make necessary preparedness and contingency plans ahead of the next shutdown.

For more information, contact your Marsh representative.