PCS Information Bulletin #30: COVID-19 Review

Wednesday, August 19, 2020

As always, please remember that **this report is for informational purposes only** and does not constitute the designation of a PCS event. We have decided to provide this report simply to help the market understand the COVID-19 situation and to provide access to some of the resources our team uses daily for intelligence on this event.

Timing is everything

If we've learned anything from retailers over the past few decades, it's that you can never start thinking about Christmas too soon! Now, you'll probably start thinking about your weird Uncle Charlie's annual October Facebook post about Christmas decorations being in stores before Halloween. We don't blame you. That is too soon, and Uncle Charlie is a clown. Instead of thinking like him, think like a retailer.

The period between the U.S. Thanksgiving holiday (late November) and Christmas day is peak for retailers. The holiday shopping season can make or break their year. And even with the rise of online shopping over the past 20 or so years, there has been no substitute for foot traffic, in-store promotion, and in-person conversion. Over the past few years, according to some high-level research conducted by PCS, the ten busiest shopping days of the year fall into the Thanksgiving-to-Christmas stretch at the end of the year. And that's in both sales and foot traffic. Of course, that model is in jeopardy this year.

It's worth taking a look at www.covidexitstrategy.org. Thirteen states and U.S. territories are identified as having an increasing rate of COVID-19 positives over the past 14 days, with another seven flat. Of the 33 where the positivity rate is declining – even by double digits in some cases – indicators of uncontrolled outbreak remain as a result of previously identified positives, strain on intensive care units, and difficulty in implementing and managing contact tracing programs. Nonetheless, let's take the broad declines of 14-day positives across the country as a positive sign (for the purposes of this exercise). It would imply that we should be around six weeks out from a vast improvement in COVID-19 positive rates (four weeks for the optimist, eight or nine for the pessimist). So, even if you're extremely pessimistic, it would look like a favorable trajectory through the end of October. If so, there would be a few weeks of cushion ahead of peak holiday shopping season.

What that rosy view of the near future excludes, however, is the prospect of another resurgence. Even with infection rates declining, there are still sufficient new cases per day to suggest that broad spread remains possible. Further, 36 states are flagged as having "Difficult" or "Extremely Difficult" prospects for contact tracing, according to COVID Exit Strategy. Weak contact tracing plus a sufficient population of positives could be sufficient to drive further transmission. Add to this the notion that, according to the CDC, those recovering from COVID-19 may be safe from reinfection for only three months. Those entering that 90-day window now or over the next two weeks could become exposed again in the middle of the holiday shopping season.

The impact of a holiday shopping season resurgence on the global re/insurance industry could be significant:

- The spread of infection and its attendant workforce impacts could lead to ill employees and reduced capabilities – always a concern during flu season anyway.
- Re/insurers could wind up with workforce impacts during the January renewal season, leaving teams shorthanded or otherwise compromised.
- Another resurgence could result in negotiating fatigue (as we've seen in past renewals this year), which could have a noticeable impact on the market. Remember what we said in our last bulletin about wrestling with a gorilla …
- Economic strain from disappointing retail projections during the holiday season could have asset side impacts for re/insurers.
- General economic uncertainty could shape the tone of the reinsurance renewal season.
- Economic malaise during a time of year that's already stressful for most people (the holidays) could result in further SRCC – and as we're seeing now, SRCC has persisted.

Retail adaptation

In previous installments of our information-only bulletins on COVID-19, we spent some time on the evolution of the retail sector's strategy over the past 30 years. In particular, retailers had invested heavily in the in-store experience as a way to compete with online alternatives. Social distancing, reduced touching (e.g., feeling inventory), masks, and other protective measures run counter to what the industry had believed would keep it relevant. That's left a wide range of changes for retailers to figure out, from the extremely tactical (tents to shade customers from the sun while waiting socially distanced outside the store) to the long-term strategic (can the high-touch model be resurrected fully after COVID-19?).

Between the two extremes, of course, is the need to remain relevant today. Retailers will need time to react to the lessons of the pandemic – and let's not forget that we're still in the middle of it. But, they need to take action today to continue to engage with customers, drive sales, and generate returns for their shareholders.

It'll be interesting to see what sorts of innovation drive retailer engagement at a time when traditional models are struggling and it's too soon to figure out what the next iteration will involve. Walmart's recent announcement to use its parking lots as drive-in movie theaters (across 160 stores) is an interesting example of presumably low-cost engagement that can keep the brand relevant. Doubtless, there will be retail sales from these events – with snacks directly related to the "parking lot retail experience" and the combination of movie night with other shopping requirements. The play falls short of strategic reinvention (as it should), but it shows what a little inventive thinking can do in the interim.

Less flashy but still noteworthy, both Target and Walmart have expanded their hours of operation in an effort to help spread crowds by creating more shopping time. It's an interesting and common sense idea – and one that came up several times during the Bermuda lockdown. Restrictions on shopping created lines and the potential for crowds (probably elsewhere, as well). Expanded hours may not completely remove peaks and clusters, but they certainly offer some potential for smoothing out foot traffic. And while expanded hours do result in increased expense, they also provide the opportunity for better customer engagement, a less stressful shopping experience, more time to browse and fill the basket, and ultimately (hopefully) increased sales per customer visit.

QSRs, Casual dining, and the consumer

As mentioned above, we've spent a lot of time on retailers in our information-only bulletins on COVID-19. Many of the issues that retailers face, though, are also relevant the restaurant sector – particularly casual restaurants and quick-service restaurants (QSRs). The QSR and casual categories bear a lot of similarity to retailers. Commoditization, price point focused on broad attainability, broad implementation of a concept nationwide (or worldwide), and sensitivity to consumer spending are just the tip of the iceberg. There's also the notion that these establishments are meant to be visited in person and are designed to increase order size/customer spend. There are some critical differences between casual and QSR.

QSR spans both in-restaurant and takeout, which means that a certain portion of their revenue should be resilient in the face of COVID-19 protective measures (although not necessarily resilient in the face of economic pressures caused by COID-19). Customers can take their food and eat it elsewhere, minimizing their impact with potential virus transmission points. In fact, QSRs with online/app ordering and drive-through capabilities, inherently deliver a reduced-risk experience, which should result in some support for revenues, as long as broader economic deterioration doesn't force more potential customers to eat at home.

The QSRs without drive-through capabilities may struggle a bit more in adapting to COVID-19 customer experiences. The notion of taking your food and walking home just isn't the same as driving with it. And the act of entering a restaurant is inherently riskier than transacting through a window from your car. Some Starbucks stores may struggle, and we've read that Shake Shack could be particularly exposed (which is tragic, as my pre-Bermuda flight ritual used to be two double cheeseburgers from the one in JFK Terminal 4!). Nonetheless, there's a reduced-touch environment across the category that provides at least some benefit.

Casual dining, however, tends to rely more on the in-restaurant experience than takeout (although there has always been some amount of revenue from the latter). This results in several pressures on revenue. First, some states don't allow indoor dining right now, resulting in revenue only from outdoor seating. Where indoor dining is permitted, social distancing measures have significantly reduced the number of seats available. Even with streamlined ordering and faster table turnover, there's a clear downward impact on revenue as a result of these new configurations.

The impact could be more interesting in suburbia than in cities. In the latter, there are always crowds and plenty of alternatives. Cities adapt. If you lose a customer in QSR or casual dining, there's probably another somewhere to be picked up. Now, think about a suburban shopping center before COVID-19, where you'd find a Chili's, TGI Friday's, or an Outback. Or any other commensurate restaurant (there's a long list of them). It's not unusual to see such restaurants packed with crowds out the door on a Friday or Saturday night, seemingly from the start of the dinner menu until the kitchen closes. There's a similar wait across all alternatives, which are likely located near each other. These restaurants used to have to turn customers away. Now, they are stuck with drastically reduced seating. They can make up some revenue from takeout, but everyone will tell you that it's just not the same. Translation: the in-restaurant experience means a lot in this category.

So, what does this mean for the insurance industry?

First, as with retail, there's the obvious connection to the consumer. Pressure on operating models makes it harder for these businesses to serve customers, which ultimately constrains top-line performance relative to expenses that are hard to move on a commensurate basis. Further, supply chain pressure has led to increased variable costs, and they can't all be passed along to the consumer (some, of course, are). Ultimately, the measures being implemented today to cope with COVID-19 may help temporarily, but they can't last forever.

There hasn't been a lot of public discussion about whether pressure on consumer-focused businesses could result in reduced demand for insurance. This certainly wouldn't be an existential threat to the industry, but for insurers focused on consumer categories, there could be some localized revenue pressure. When businesses file for bankruptcy, close large numbers of stores, or otherwise financial pressure, there's always a look at expenses, and this could impact the amount of cover they're willing to buy.

Some additional reading:

https://www.businessinsider.com/restaurant-chains-at-risk-of-bankruptcy-amid-pandemic-2020-8

https://www.washingtonpost.com/dc-md-va/2020/07/07/le-diplomate-burger-beef-supply-chain-coronavirus/?arc404=true (fascinating piece, a must read)

https://www.bloomberg.com/news/articles/2020-08-14/america-s-favorite-pizza-topping-is-starting-to-get-scarce?sref=P6Q0mxvj

The other November risk

Tuesday, November 3, 2020. There are countless reasons why the global re/insurance community is waiting for that day with interest. The next U.S. presidential election could have a profound effect on our industry, as could the aftermath. A contested election, allegations of problems with mail-in votes, and a host of other issues could lead to legal disputes, public disagreements, and financial market reactions. For now, the primary potential outcome that PCS is preparing for is SRCC.

PCS's date range for the spring riots in the United States were May 26th to June 8th. Since then, there have been outbreaks of civil unrest in Portland, Oregon; Chicago, Illinois; and other cities across the country. However, the insured losses from these events have not reached the PCS catastrophe-designation threshold of US$25 million. It's a difficult threshold to reach for this peril, and only 13 SRCC events have become PCS-designated catastrophes in the past 70 years. The more recent instances of unrest have either not involved significant amounts of physical damage or involved physical damage primarily to government structures, with little insurance industry impact.

The November election could contribute to another wave of widespread riot and civil disorder in the United States, potentially with the scale to warrant PCS catastrophe designation. To prepare for this sort of situation, re/insurers can do the following:

1. Identify lessons from the May/June riots affecting more than 20 states. This was the first multistate riot and civil disorder event in PCS history. If a November event were to occur, re/insurers should be ready for it to involve several states.

2. Review hours clauses, particularly in light of how they reacted to the May/June riots. Some require contiguity of states or counties, and as we saw recently, demographic and psychographic contiguity are more relevant today than the geographic contiguity originally contemplated in reinsurance treaties.
3. Check your book for exposure to large consumer-focused risks. Retailers and QSRs could be especially vulnerable, as we saw several months ago. Such programs are exposed to nationwide events and can accumulate losses quickly, as demonstrated by our entries for CVS and Walgreens in the PCS Global Large Loss platform.
4. Take a look at your reinsurance covers (both inward and outward) for SRCC exposure.
5. Review the loss experience (as available) from May/June.

And don't forget to reach out to the PCS team. We're more than happy to discuss SRCC, the large risk landscape, and other factors related to this issue.

Canada, Catastrophes and COVID-19

Last week we examined the potential for a major catastrophe event exacerbating the spread of COVID-19 in Japan. Prior to that we explored the rise of COVID-19 in two of the most COVID stricken states in the U.S., Florida and Texas, along with the planning and mitigation effects before and after Hurricane Hanna made landfall. As we continue to look at countries which our PCS team operates catastrophe loss indexes, Canada, which of course we have PCS Canada, with its population of nearly 38 million is also a significant market with major cities and COVID concerns.

2020 has proven to be an active catastrophe year in Canada and is the second most active year with catastrophe event frequency since the inception of PCS Canada in 2010. Thus far our PCS team has designated 11 catastrophe events in Canada. Several of those events, such as the Alberta Ice Jam in April and the June Alberta hailstorm have generated two of the largest catastrophe events on record in Canada. Earlier this month after Tropical Storm/Hurricane Hanna affected the Caribbean and touched every state on the eastern seaboard of the U.S., the remnants of Hanna continued to travel north into Canada warranting a PCS Canada catastrophe designation.

While some countries are reopening their international borders, Canada has maintained its stance and continues to keep its doors firmly shut to most international visitors. In March, the Canadian federal government issued several emergency orders in response to the COVID-19 pandemic under its Quarantine Act. One order bans non-citizens entering from the U.S. and a second bans all other non-citizens from visiting Canada — unless their travel is considered essential, such as for school or work. A third order mandates a 14-day self-quarantine for anyone entering the country.

Regarding Alberta which has experienced a high percentage of Canadian catastrophe events and has multiple major metropolitan areas, as of August 18th there were 1,132 active cases in the province, including 300 active cases in Calgary and 593 in Edmonton. On Monday August 17th, the province reported 285 people in Alberta tested positive for COVID-19 over the weekend: 103 on Friday, 86 on Saturday and 96 on Sunday. Calgary Transit is moving to full capacity on all CTrains and buses, citing a high compliance with the mandatory masking rule.

In Quebec, the province hardest hit by COVID, 46 new cases were reported as of August 18th, bringing the total number of infected persons to 61,252. The Canadian province of Quebec announced plans this week to continue the fight against the COVID-19 pandemic, while preparing its health sector against a possible second wave of coronavirus in the autumn. Under the plan, Quebec will also invest C$106 million ($80.58 million) in public health to allow for the hiring of 1,000 workers to do contact tracing and infection control.

Thus far, Hanna nor any of the other catastrophe events that have struck Canada have required large, widespread evacuations. If a major catastrophe event were to occur in the previously mentioned provinces or in Ontario, which has been included in several PCS Canada catastrophe designations this year with its population of 15 million and includes the City of Toronto and it Greater Toronto Area (GTA) which is one of the most populous regions in North America, the situation in Canada regarding COVID spread could change rapidly. Currently, Ontario has experienced nearly 41,000 cases with nearly 2,800 deaths compared to Florida which has totaled 580,000 cases and nearly 9,800 deaths.

As of the morning of Tuesday August 18th, Canada had 122,872 confirmed and presumptive coronavirus cases. Provinces and territories listed 109,059 of those as recovered or resolved. Regional health information and reporting of deaths stood at 9,070.