PCS Information Bulletin #32: COVID-19 Review

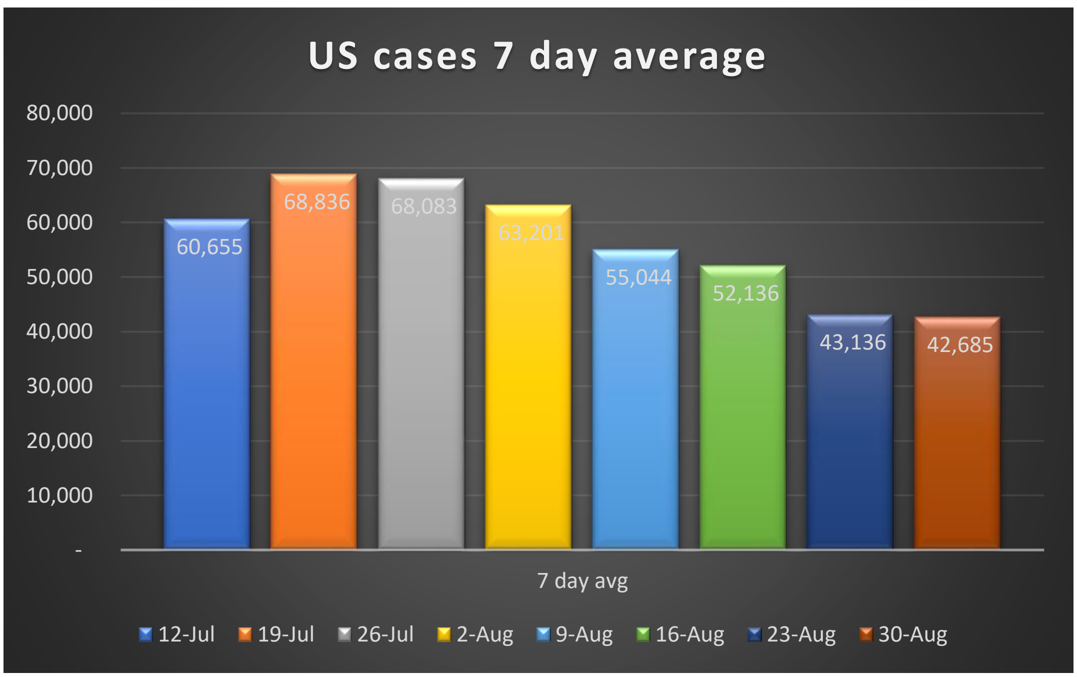
Wednesday, September 2, 2020

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.

COVID-19 Cases International Overview

We've been talking about a second wave of COVID-19 cases coming this fall, and it seems to be happening. Internationally, we've seen some significant upward development over the summer.

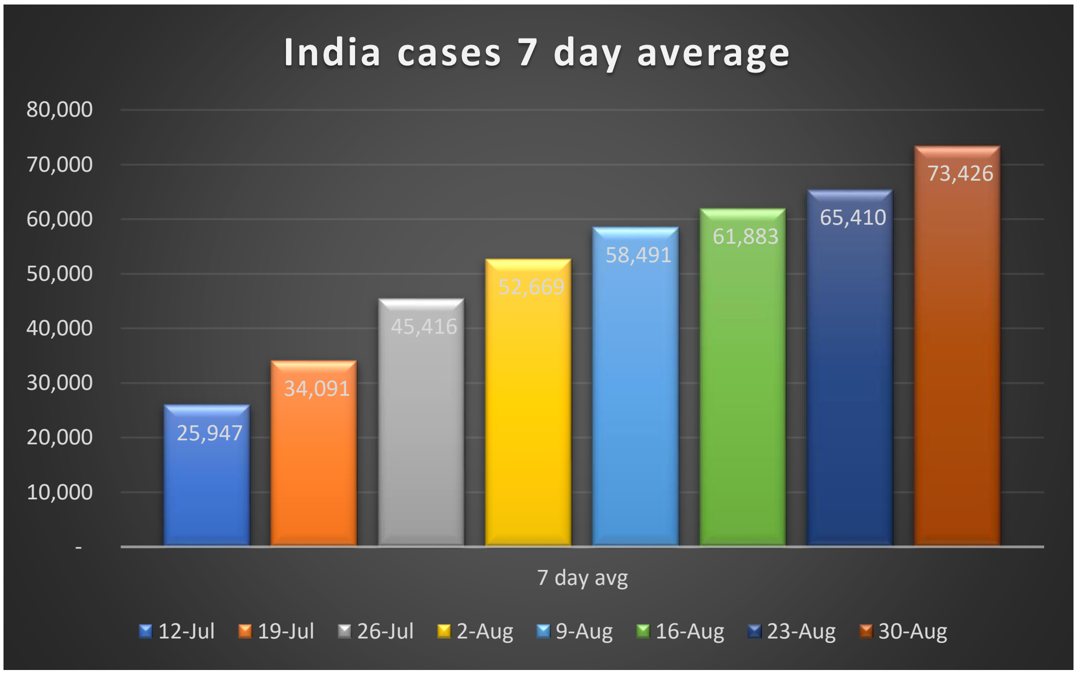
The United States continues to post the largest number of infections, with more than six million so far. More than 47,000 new cases and almost 1,000 additional deaths have been reported Sunday, August 30, 2020, and with many schools and universities now opening their doors, we may see further increases across the country. This comes following a downward trend in the United States' seven-day moving average – with around 42,700 cases at the end of August (compared to over 68,000 at the end of July).



Source: Worldometers.com

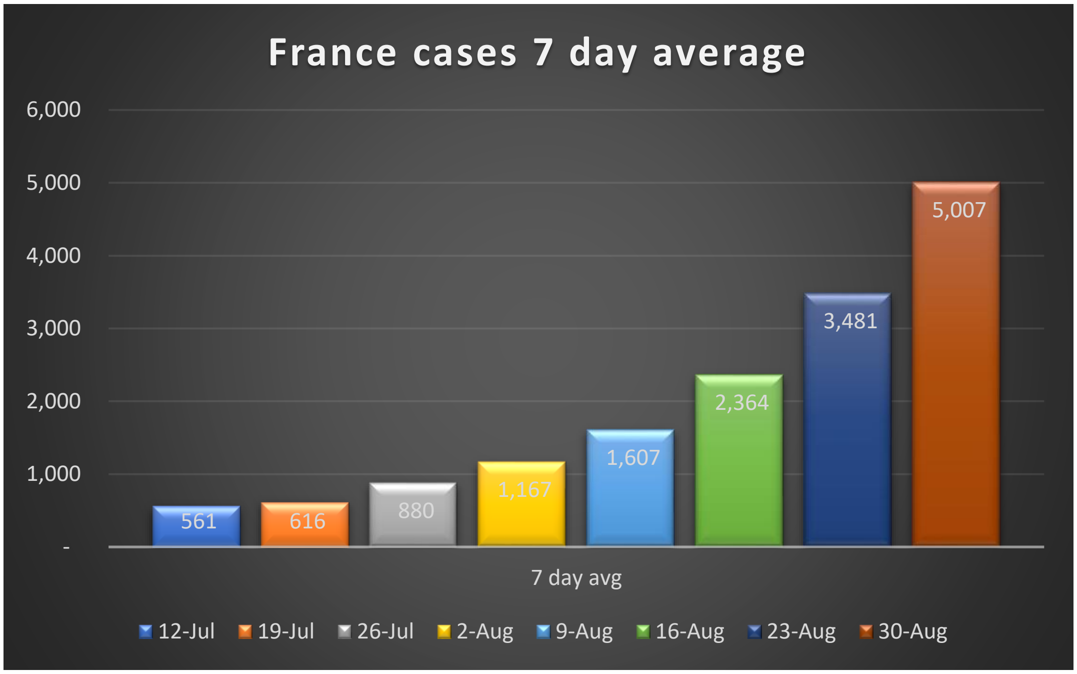
India, currently ranked third worldwide, is fast becoming a pandemic hot spot. The country registered a record 79,457 new coronavirus cases on Sunday, August 30, 2020. That is the worst single-day COVID-19 spike the world has seen so far, although the health ministry noted that the nation also set a record with more than 10 million tests. The seven-day case average has increased to 73,426 cases per day, compared to just over 45,000 cases at the end of July – an increase in cases of more than 50 percent.

India officially lifted its strict nationwide lockdown in June, which appears to have put the country's COVID-19 transmission on a steep upward trajectory. India recorded one million cases in around five months from the start of the pandemic, while the next millions came significantly faster – 25 days for the second million and only 16 days for the third million. Testing has increased dramatically but remains far below that of many other countries on a per capita basis. A recent survey in India's capital found that 29 percent of people had antibodies. If accurate, that would translate into at least 6 million infections in Delhi alone. Compared to Brazil and the United States, at similar points in their respective outbreaks, India has a lower rate of death as a percentage of cases. Experts are saying that because India has a predominantly youthful population this factor may be helping to reduce fatality rates.



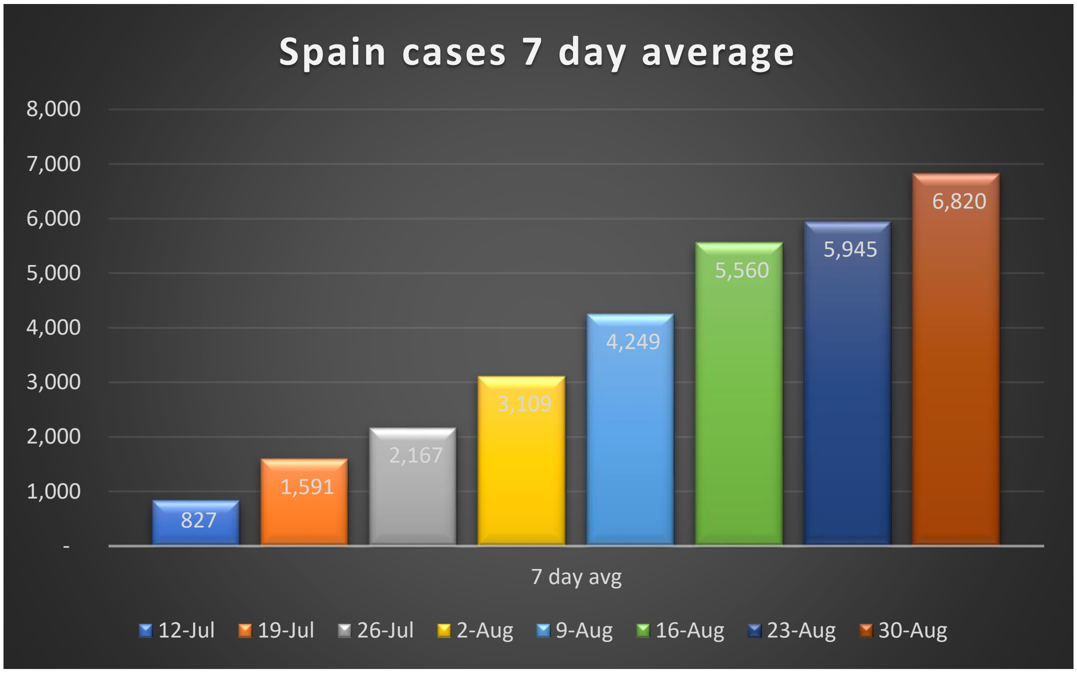
Source: Worldometers.com

France reported 5,413 new daily infections Sunday, August 30, 2020, compared to several hundred a day in May and June. The seven-day case average has increased to 5,007 cases per day, compared to just a little under 1,100 a month ago at the end of July. France was late to increase its testing capacities compared to countries like Germany. The national public health authority has acknowledged that the reported number of test-confirmed cases was lower than the real number of cases which has led to the spike that we are currently seeing.



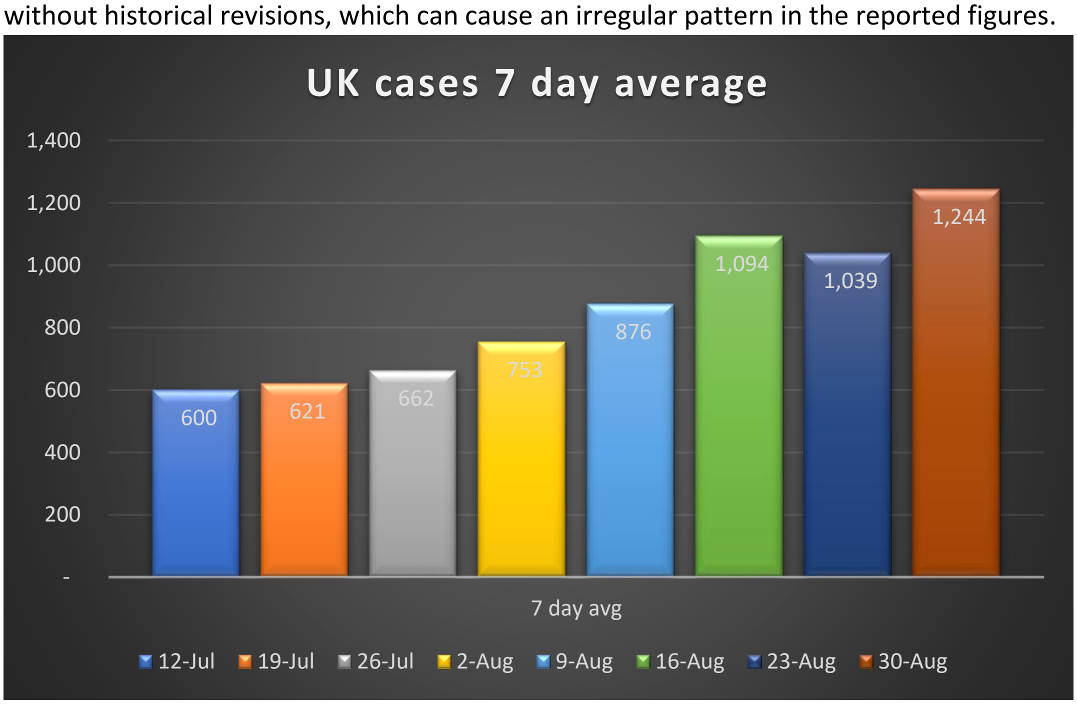
Source: Worldometers.com

Spain has recorded the most new cases on the continent by far – more than 53,000 in the last week of August. The seven-day moving average is up to almost 6,800 cases, compared to a little over 2,000 cases only one month ago at the end of July. With 114 new infections per 100,000 people in that time, the virus is spreading faster in Spain than in the United States, more than twice as fast as in France, about eight times the rate in Italy and Britain, and ten times the pace in Germany. After one of the world's most stringent lockdowns, it then enjoyed one of the most rapid reopening which has led to the spike in cases far faster than most of its European neighbors.



Source: Worldometers.com

United Kingdom has recorded an increase in cases, registering 1,715 new cases on August 30, 2020, the highest number since the lockdown measures have eased, but lower than other countries on the continent. The seven-day case average has increased to 1,244 cases per day, compared to just over 650 cases at the end of July. The UK government changed its methodology for counting Covid-19 deaths on August 12, 2020, lowering the overall death toll by more than 5,000. The change in methodology leads to revised data or report on a single-day large increase in cases or deaths from unspecified days and without historical revisions, which can cause an irregular pattern in the reported figures.



Source: Worldometers.com

SRCC during the pandemic – Increased estimates, increased costs and increased risk

In the midst of the global response to the COVID-19 pandemic, SRCC events are continually sparking across the U.S. New SRCC activity has erupted in the past several weeks in Portland, Chicago and Kenosha, Wisconsin however none of these events have reached levels of industry wide claim activity to warrant a PCS catastrophe designation at this point. Yesterday on September 1st our PCS team released our first resurvey for Catastrophe 2033, the riots sparked by the killing of George Floyd. Needless to say, there has been a substantial increase between the preliminary estimate and resurvey. As more data has become available since our preliminary estimate it is abundantly clear that this event may have a long tail regarding fully assessing the losses that have occurred. Large program loss data for retailers that have multiple locations in multiple states has had an impact on this event and loss estimate unseen in any prior SRCC event.

This event has become the largest SRCC event in the seven-decade history of PCS and the estimated insured losses to date nearly triple that of the 92 LA riots. Twenty-four locations, which includes twenty-three states and Washington, D.C., incurred estimated losses that rival some hurricane events. While most events have significant personal and auto line losses, the vast majority of losses from this event are in the commercial category.

Losses driven by physical damage to structures, inventory loss and heavy business interruption losses have generated numbers not historically expected of SRCC events. The scale of this event affecting states coast to coast was not a fortuitous event that actuaries and underwriters would largely have not anticipated. While the impact on future rates remain to be seen, the more immediate impact of the cost of the associated claims is still in the forefront. And while many states and cities sustained damages, Minneapolis and St. Paul incurred the lion's share of the event losses and reports indicate that property owners are now faced with another challenge to indemnifying their losses, unexpectedly high costs of demolition. While many reports focus on this aspect regarding losses in Minneapolis and St. Paul, this issue would certainly not be limited to this one location.

Some reports indicate demolition costs are so high that many rebuilding, repair and restoration projects are delayed, leaving large sections of Minneapolis and St. Paul with scorched buildings and piles of rubble that will linger for months. Some policies have sub-limits on applying to demolition for $25,000 to $50,000, however contractors have been submitting bids of $200,000 to $300,000 in some reports. In many cases, the price of the work is not much lower than the actual value of the property, records show. Contractors have acknowledged that prices for riot-related work are far higher than usual, but they said that is because government regulations require them to treat all debris from a burned-out building as hazardous and can double demolition costs.

Some property owners have requested city officials to take the lead with contractors by combining their projects and seeking public bids for the work. On July 2nd, Minnesota Governor Walz asked President Trump to declare a major disaster in Minnesota, authorizing federal assistance for the over $500 million dollars in damage caused by vandalism, fire, or looting. That request was denied. A FEMA spokesperson told Minnesota Public Radio, "After a thorough review of Minnesota's request for a major disaster declaration from extensive fire damage as a result of civil unrest in late May and early June, it was determined that the impact to public infrastructure is within the capabilities of the local and state governments to recover from. The governor has 30 days to appeal that decision." As of August 7th, Governor Tim Walz appealed the decision. Gov. Walz also requested a U.S. Small Business

Administration disaster declaration that would free up low-interest loans to help property owners rebuild.

The Small Business Administration (SBA) is offering disaster loans of up to $2 million to businesses and residents in the Twin Cities who incurred financial damage from the protests and riots in late May and early June. The SBA said it will offer low-interest loans repayable over as long as 30 years for working capital and to repair damage that happened from May 27 to June 8. The agency will accept loan applications until early October. For small businesses and small agricultural cooperatives, and most private nonprofits, SBA offers Economic Injury Disaster Loans to help meet working capital needs. They are available regardless of whether the business suffered physical property damage. Homeowners and renters who incurred related damage are eligible for loans of up to $40,000.

The situation in Minneapolis and St. Paul is a microcosm of the experience that property owners across the U.S. are experiencing regarding their efforts to get back to the "new normal". PCS with the inputs from our data contributors and connections through the industry will continue to update our subscribers on this event and our next resurvey on Catastrophe 2033 can be expected in early November.

SRCC Capacity: Is Change on the Horizon?

It seems like everything this year will be "too soon to tell" with the implications to be "played out in the coming decade." And at the risk of boring you with such thinking, well, here we go again. Strike, riot, and civil commotion (SRCC) activity in the United States has been an issue since the end of May. Although not all of it is classified as PCS-designated catastrophe activity, the ongoing uncertainty and unrest have created a climate where another major riot event could happen almost at any time.

In fact, there are several situations in the United States right now that could serve as triggers for a resurgence of catastrophe-level SRCC activity, including any decision on indictments in the Breonna Taylor case in Kentucky, the long-term protests in Oregon (which have been highly focused geographically), and the recent shootings in Kenosha, Wisconsin. And that's in addition to a wide range of economic and policy factors that could cause more unrest.

How the insurance industry will respond to these conditions remains to be seen. The Chilean riots of 2019, however, may provide some insight into potential market dynamics. Last year, a handful of retailers sustained insured losses of close to US$1 billion in Chile as a result of the riots, roughly half from one company. When that company sought to renew its property insurance, it's been reported that SRCC had to be moved from property to the political violence market. The other retailers affected were generally regional, so the move wasn't enough to stimulate an immediate trend.

The U.S. riots complicate the market dynamic. PCS has kept a close eye on retailers' insured losses, as you've probably seen in previous editions of our information-only bulletins on COVID-19. So far, we've seen three rise to a level where we need to watch them for PCS Global Large Loss reporting (https://www.artemis.bm/news/why-large-risk-loss-ilws-are-coming-back-covid-19-a-factor-pcs-johansmeyer/), which has a threshold of US$250 million and worldwide scope. Further, we're aware that several losses notified so far likely include only physical damage, with the potential for significant

increases later this year. The number of individual large losses could increase significantly. Based on client conversations, most large national retailers still have SRCC in their property programs.
Could that change?

Well, of course, it's "too soon to tell," and we'll see how the implications are "played out in the coming decade." It would seem simple, though. Following sector-wide significant large losses, insureds would be pushed to move SRCC to the political violence market, as the one retailer did after the Chilean riots. Market dynamics are rarely that straightforward, though.

The loss in Chile could be characterized as different from the United States, because it could be said that nobody expected Chilean SRCC to exhaust a full tower. Also, the event in the United States was truly unprecedented – both in insured loss and in the fact that it was the first PCS-designated riot and civil disorder event with more than one state designated (in fact, more than 20). Depending on how the discussions are handled, there are ways that insureds could keep at least some SRCC cover (if not all), through a variety of structural possibilities.

The next issue is capacity. Let's assume that insureds are convinced that they need separate cover for SRCC and turn to the relevant market. Even if only loss-affected retailers turn to the SRCC market, whether there's enough capacity to satisfy them at reasonable rates is questionable. In the London market, there's historically been a certain confidence in claiming that "there's always enough capacity." That may have been true, to a certain extent, before the confluence of a pandemic and major SRCC event in the United States following several active catastrophe years. Additionally, even when capacity was claimed not to be an issue "for anything" among the Lime Street set, a certain inflexibility of terms and allocation was almost always implied.

Finally, there's price. Depending on the cost of the additional protection, insureds may have to make difficult choices about how much protection to secure, whether to modify their overall approaches to insurance buying, and possibly to decide that they'll just need to assume some amount of property or SRCC risk. Insureds' budgets aren't endless, and in many cases aren't all that flexible. The thought that significant increases in insurance purchasing would be readily approved during a pandemic-driven recession would be – to say the least – optimistic.

In the face of complexity and negotiating fatigue, sometimes the status quo simply wins by default. The above market conditions cry out for the application of advanced analytics and structural creativity to advance our industry's capabilities, so there truly is an opportunity here … that could "play out in the coming decade."

Pandemic Parametric Covers: One Reason to Be Pessimistic

Especially in the early days of the COVID-19 pandemic, the PCS team wrote a lot about parametric risk transfer in these information-only bulletins. And there's been plenty of chatter in the market. However, action has been in short supply. The reason should come as no surprise.
Price.

When a new opportunity to expand protection or an emerging risk gains momentum, protection sellers see an opportunity. New risks can be harder to price because of limited historical information and differences in interpretation. Pricing can include both uncertainty loads and novelty premiums. Of course, we've seen that pricing generally declines over time. Even large, market-changing events don't really bring rates back up.

Pandemic seemed to bring such an opportunity. Sure, there's been some pandemic risk transfer on a parametric basis in the recent past (well, relative to 1918) – not to mention the World Bank insurance linked securities (ILS) transactions that were in place ahead of COVID-19. It had never really scaled, though. The conventional wisdom seemed to be that an industrywide event would change the nature of demand.

So far, it hasn't. And it starts with the original insured. Insurers, reinsurers, and ILS funds generally don't have access to a risk without an original insured to kick off the process (there are cases where the chain gets a bit mixed up, but they are relatively rare). Original insureds haven't shown much demand for parametric cover, according to a very light effort (to be honest) by PCS. To understand why, you need to pick through the click-bait headlines and broad reports of economic carnage to see how specific constituencies were affected. The examples below aren't intended to be exhaustive, but they should give you a few ideas.

1. Businesses that can transition to work from home for a sustained basis with minimal disruption to the customer experience would presumably suffer much less economic impact from the pandemic. Increased friction from the work-from-home experience – falling far short of true operational strain – would likely not require the need for specific insurance protection, we learned from risk manager interactions, intermediaries, and protection sellers over the past few months.

2. Businesses that provide a service required by some sort of authority have upward pressure on demand relative to economic conditions. If there's a legal or regulatory requirement to consume a certain product, then there's likely less elasticity of demand, and the product itself begins to look more like an essential good. Unlike point #1 above, this is demand-driven. This doesn't provide any sort of immunity to supply-side woes, though. Suppliers of such goods – if they are physical – could encounter supply chain issues that limit the ability to fulfill.

3. Essential goods are, of course, essential. Even in customer-facing and highly tactile environments, demand should persist, and so far, we've seen supply chains able to deliver on basic grocery, pharmaceutical, and other day-to-day essential consumer goods. As a result, the need for pandemic cover may be somewhat limited.

4. Nonessential goods, on the other hand, could benefit from pandemic-specific cover, particularly for business interruption. There's hardly a day that goes by without a retailer-related bankruptcy story in the press. It's important to keep in mind that many of those retailers already had issues to address before the pandemic. So, the pandemic may have become an existential threat more easily as a result. Retailers in this category would be more price sensitive, though. Retailers have historically had razor-

thin margins, which makes extra expense of any kind difficult to assume. Whether this thinking is set to change remains to be seen.

5. Restaurants have fared similarly to nonessential goods retailers. Many have suffered, some have shuttered, and there's been an effort to pivot to take-out business in order to bypass the steep fees associated with delivery services like Uber Eats and Grubhub. Like retailers, unfortunately, restaurants tend to have thinner margins, which can make them struggle to take on new expenses.

The expense theme is a difficult one. For companies not heavily exposed to pandemic risk – at least as it's manifested so far with COVID-19 – there's a sense that a small percentage increase to existing premium only would be worth considering (but still not assured). So, if a company's property program were 2 percent rate on line (ROL), the addition of pandemic coverage would only take it to ~2.05-2.09 percent ROL. Higher ROLs may be possible for businesses at greater risk, such as nonessential goods retailers, but their businesses may struggle to assume the additional expense.

On the protection supply side, there could be some light market opportunity for expansion, although the assumptions above don't fit well with how protection sellers would want to respond to a need for pandemic cover. In the end, clearing prices seem likely to be reached only for niche trades, which would result in little market evolution. It's still early days, and we hope there's more market expansion potential. But for now, ability to find a clearing price is a reason to remain a pessimist.

COVID-19 and the Fitness Market.

It didn't take long for folks emerging from lockdown to want to shed their "COVID 19" lbs – a bit of wit that made the rounds. Working in close proximity to the refrigerator and shopping in volume to minimize trips to the outside world could provide a clear and present danger to the waistline. And it's a situation that has been exacerbated in markets where reopenings have been slow. In many parts of the United States, for example, gyms have yet to open, constraining one's alternatives for shedding all that ice cream weight.

Increased demand, retailer and manufacturer forecasting models unable to cope with the impacts of the pandemic, and slowdowns in supply chains have left the fitness business something of a mess. The implications have been varied and fascinating (https://www.businessinsider.com/12-ways-pandemic-has-changed-fitness-as-we-know-it-2020-8). Gyms: Some have tried to reopen with classes in parking lots. Others have turned to Zoom for group fitness sessions. We saw one article where a hotel offered literal bubbles for each participant in a class. There are also reports of "speakeasy" gyms, although we didn't see any mentions of secret knocks. As gyms reopen, some question whether prior devotees will return in significant volume. Some will lose interest, while others may find new ways to exercise.

Bicycles: Record sales have swept the country, with some up 600 percent (https://www.businessinsider.com/united-states-is-running-out-of-bikes-during-coronavirus-pandemic-2020-5). Many bike shops have big gaps in their racks (we've seen this down here in Bermuda). Even high-end manufacturers have been affected. Ibis (premium mountain bikes) is said to be two months behind in fulfilling orders. Shimano, according to one retailer PCS spoke with, "is a mess." Efforts to increase manufacturing and fulfillment may help, but many of these manufacturers were never ready to deal with a temporary spike in demand of this magnitude.

Free weights: The situation here is roughly the same as it is for bicycles. They are almost impossible to find in any reasonable weight, according to several reports. For example, some retailers only have weights of 95 lbs. and up. That may work for the PCS director of operations, but everyone else may struggle a bit. Others have seen very low weights available, but the range spanning beginners to the reasonably fit (say, 5-60 lbs.) is notoriously difficult to source. Many who used to go to the gym and still want to pump some iron are now scouring retailers for the slightest hint of inventory. With 95 percent of dumbbells manufactured in China with annualized forecasting, it seems that the market has struggled to respond. (One of the PCS team members curled water jugs and bags of logs during the worst of the lockdown. It's not a long-term solution).

In-home equipment: Peloton, NordicTrack, and other vendors of in-home exercise equipment have surged during the pandemic. The former reveals a weeks-long backorder, with the latter boasting a 600 percent increase in sales in May. It seems safe to assume that pre-pandemic demand patterns were such that they were able to adapt more easily than free weight manufacturers.
There may not seem to be any direct lessons here for the re/insurance community – aside from consumers of the above products (you can't swing a stick without hitting a Peloton rider in Bermuda, these days). A deeper look, though, shows what this sector can tell us:

- Even within a category, there can be variability in response to and performance during the pandemic. Viewing markets by a limited set of broad characteristics can mask significant differences within it. Whether it's fitness equipment, quick-service restaurants, or anything else, granularity provides actionable insight. Take the time to learn about subsectors and individual businesses.

- It helps to understand the demand patterns that a company experiences. Some may not need sophisticated forecasting tools or techniques – such as manufacturers of free weights. Others may have seasonal considerations, new product launch cycles, or short operating histories that translate to a relative lack of penetration (e.g., Peloton). These details will shape how a company can respond to a pandemic or other massive interruption of commercial activity.

- Adaptability and flexibility can help companies bridge through periods of difficulty and uncertainty – as exercise bubbles and Zoom classes show. Revenue may not be consistent with ordinary operations, but there's the opportunity to fend off an existential threat. Creative thinking can lead to longevity and resilience. And sometimes, it's spontaneous creativity – rather than disciplined strategic planning – that a company needs most.

When times change, you can't look at your market the same way. Dig a little. Test your old assumptions. Figure out how client leadership teams may think and adapt. You don't need to abandon old measures, but it helps to mix in some spontaneous creativity every now and then!
Interesting reading on spontaneous creativity and flexibility:
https://www.washingtonpost.com/business/2020/08/28/friday-night-takeout-pandemic/

UPDATE: Reopenings Planned at New Jersey's American Dream Mall

Covered in our previous information-only bulletin on COVID-19, the American Dream mall (with its indoor ski facility) is set for a limited reopening (https://www.nj.com/coronavirus/2020/08/american-dreams-indoor-ski-park-announces-reopening.html). The Big Snow ski facility was set for its official reopening on September 1, 2020, although with a variety of social distancing protocols. Additionally, 17 retailers have been cleared to open, as well (https://www.nj.com/news/2020/08/when-american-dream-reopens-these-18-stores-will-be-ready-to-debut.html