PCS Information Bulletin #32: COVID-19 Review

Wednesday, September 9, 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.

What's Next for COVID-19?

Transmission and fatalities have appeared to start heading in the right direction in the United States, although there are still some signs of concern. Countries in Europe have been forced to take action with pockets of increased cases reported, and India has outpaced Brazil in reported cases, making it second only to the United States. And winter is coming. It's believed that an autumnal surge of COVID-19 could peak after the November 3, 2020, U.S. presidential election and ultimately lead to 410,000 fatalities by the end of the year (https://www.washingtonpost.com/health/coronavirus-fall-projections-second-wave/2020/09/04/6edb3392-ed61-11ea-99a1-71343d03bc29_story.html). That would be an increase of more than 100 percent from where we are today. This would also cause COVID-19 to clash with the traditional flu season – not to mention the busiest retail period of the year (https://www.washingtonpost.com/health/covid-flu-season-collide/2020/09/04/23254d68-eb98-11ea-99a1-71343d03bc29_story.html).

A November/December COVID-19 resurgence event could also play a disproportionate role in the January 1, 2021, reinsurance renewal. A significant increase in cases or fatalities could directly affect some lines of business, change model inputs to account for potential capital implications, and cause terms and conditions to get much more attention than was already expected. And terms and conditions were already expected to get a harder eye.

How Do You Reconcile Social Distancing with an Increased Workload?

Social distancing, mask requirements, and the general risk of COVID-19 transmission have led many to take their shopping habits online. They can get what they want, cruise a wider variety of stores from the couch, and not put themselves at risk by going out. The significant increases in online shopping, though, aren't without consequences.

Due to illness or a fear of becoming ill, some warehouses are struggling with maintaining staffing levels, which can be problematic enough when the throughput of goods stays consistent. An increase, of course, could only exacerbate the situation.

The fulfillment of online orders has led to increased throughput at warehouses and distribution centers. Increases in staffing to handle the load require that more people fit into existing workspaces, which of course, increases the risk of transmission. Workers go home at the end of the day, and the cycle is perpetuated.

Holiday season is coming faster than usual – literally. Kohl's – the world's fifty-fourth largest retailer – accelerated its official holiday season start to August 30, 2020. Presumably, other retailers will follow suit, if they haven't already. The drumbeat of holiday-themed promotions designed to stimulate customer activity should push more goods through the warehouses, requiring increased labor to handle the load.

There are a few risks worth considering:

- The risk of increased COVID-19 transmission, especially around warehouses and distribution centers, is an obvious concern. Pack a lot of people into the same area, and risk pandemic risk follows. When they return home, they put their families at risk.
- A shortage of labor – due to illness or the fear of illness – would increase fulfillment complexity, delays in orders, and customer dissatisfaction. It could also affect online retailer strategy. Many online orders come with some sort of expectation as to fulfillment speed (e.g., Amazon Prime). Backlogs in warehouses could cause companies to fail in meeting such expectations or (in the extreme) adjust their commitments. For customers contracting for fulfillment speed with services like Prime, the risk of dissatisfaction could increase profoundly.
- Workplace error and injury risk seems to increase when there are labor shortages paired with higher throughput and increased expectations of staff.
- Customer spending decisions could change based on having to wait longer for fulfillment, introducing the risk of purchasing less, purchasing cheaper alternatives, etc.

Overall, COVID-19 has had salient supply chain implications, as we discussed in last week's edition of our information-only COVID-19 bulletins. Mass shortages of consumer goods don't appear to have been a problem, but there have been sporadic shortages based on spikes in demand – from March's panic buying of toilet paper to the recent shortage of laptops as a result of distance learning demands and the "back to school" season. Any impact to fulfillment as a result of holiday season demand, though, would bring a new variable into the situation. And it's worth remembering how high the stakes are for the holiday season – not just for retailer financial statements but also for consumers. Not having a "real Christmas" could become a contributing factor to increased SRCC risk.
Useful resources:
https://www.washingtonpost.com/business/2020/09/03/overworked-exhausted-warehouse-workers-brace-frenzied-holiday-rush/
https://www2.deloitte.com/uk/en/pages/consumer-business/articles/global-powers-of-retailing.html
https://www.cnn.com/2020/09/02/tech/laptop-shortage-remote-learning/index.html

An Update on the Tokyo Olympics – Event Cancelation Implications

It looks like the Olympics will be held next summer, regardless of whether there's a vaccine for COVID-19. At least that's the latest coming from the Japanese government and the CEO of Tokyo 2020 (https://www.washingtonpost.com/world/asia_pacific/tokyo-olympics-japan-coronavirus-vaccines/2020/09/03/8e858c88-e799-11ea-bf44-0d31c85838a5_story.html). There are plans for acquiring and disseminating vaccines if they become available by the Games' July 24, 2021 opening ceremony. The contingency plan could certainly help reduce risk and increase the enjoyability and financial success of the 2021 Olympics. What could happen without a vaccine, though?
For the past few months, the global re/insurance community has spent a considerable amount of time on the contributions of event cancelation and contingency to an estimated worldwide COVID-19 insured

loss that seems to be forecasted to reach US$70 billion. The best guesses PCS has heard put event cancelation and contingency at 10-15 percent of the overall COVID-19 industrywide insured loss. Of course, they Olympics could comprise a significant portion of that amount.

Estimating the insured loss for the Olympics is no easy task. And figuring out the implications of different "partial" scenarios only complicates the effort further. The one outcome that seems unlikely, according to our conversations across the market, is a total loss relative to the Games. With that in mind, let's take a look at some of the financial/market components of the Olympics and what a no-vaccine event could mean.

In person attendance and ticket sales would be most likely to suffer if the Games were held absent a vaccine. Even if crowds wanted to attend, there would be plenty of natural barriers. First, travel to Tokyo would be (at best) difficult. So, anyone trying to get to different Olympics events would likely be a citizen or resident of Japan. Further, if any attendance were permitted, it would have to be at a small fraction of what the various venues could hold. Some outdoor events may still draw spectators (e.g., cycling), but without financial upside.

Concessions follow people, so there's a seemingly limited upside for venue-driven sales. As mentioned, non-arena events like cycling and marathon may still yield opportunities for some concessions, but again, it would seem like only a small percentage of what the Games normally generate. Other on-site commercial support could be expected to suffer as well.

Hotels, restaurants, and other travel and tourism infrastructure would probably suffer as well, for the same reasons as in-person attendance/ticket sales. There may be some revenue opportunity from in-country tourism, but overseas crowds wouldn't be possible.

Television revenues shouldn't be impacted all that much, at least based on audience availability and general interest in the event. There's some sense that a year of pent-up demand may be beneficial, although that could be at least partially offset by diminished interest after having to wait a year. Also, whether the extra year causes lesser performances by "exciting" athletes or even forces changes in who attends the Games could be problematic. There are always some athletes who are identified as likely to break records or otherwise thrill crowds. If the delay costs the Games those performances, then there could be an audience downside. As far as direct television revenue, it's difficult to ascertain the full impact without a detailed knowledge of the television advertising contracts in place (which can get pretty complex).

Merchandising could still perform well and may even benefit from an extended sales period (with an extra year of consumption). Expanded product lines may provide further opportunity to drive spending – such as the recasting of "2020" products with a "1" embedded in the final zero of "2020" (example at https://www.swimoutlet.com/usa-swimming/). Consumer spending could also be seen as an opportunity to provide further support for the Games absent the ability to attend or witness the crowds while watching on television.

Grocery at the Expense of Everything Else

To understand the impact COVID-19 seems to have had on the retail sector, it may help to look at what Craigslist did to the newspaper classified business. I did some consulting work for a community newspaper group around 15 years ago, when the Craigslist threat began to become apparent (which meant it was too late, really). The wholesale carnage wrought by online classified sites like Craigslist on the newspaper industry was net-destructive. If memory serves, replacements for newspaper classifieds generated only roughly a quarter of the revenue of the alternative they destroyed. Yes, revenue went somewhere new. No, it didn't translate to overall growth.

Now, think about the benefits lately being enjoyed by grocery and some big box retailers (we've covered this a bit in earlier installments of our information-only bulletins on COVID-19, too). In March 2020, the average monthly grocery bill in the United States reached US$525 – up an astounding 30 percent year over year. By July 2020, the average monthly grocery tab was US$455, still reflecting a 10 percent increase from July 2019. For what's typically a fairly stable category, 10 percent is even bigger than it looks.

There are a few interesting dimensions to the increase in grocery spending and other retail behavior (https://www.washingtonpost.com/business/2020/09/01/grocery-shopping-coronavirus-impact/):

- More people are eating at home (and preparing their own meals) than are either dining out or using takeout from restaurants. The result is not just a significant increase in grocery sales but an overall decline in food-related spending. A prepared meal tends to cost significantly more than the ingredients one would use to prepare a similar meal. It's just like the newspaper classified ad revenue – one category has seen an increase, but it's much smaller than the overall decline in spending.
- Wholesale club shopping and other forms of bulk purchasing have grown in popularity. This sort of behavior can help minimize the need to visit the grocery store, which reduces exposure to COVID-19.
- Stores and manufacturers have narrowed their marketing focus. Companies have reduced the number of SKUs on shelves significantly (a decision all the way up to the manufacturer) in order to focus their limited resources on manufacturing and shipping items that are likely to appeal to consumers. Especially when customers want to spend less time in the store – and retailers want customers in and out faster – this makes sense. Pressure on supply chains, social distancing at manufacturing facilities, and the availability of component parts/ingredients may contribute to this, as well.
- Consumers are doubling down on old habits. If you were a healthy eater before the pandemic, apparently, you're more likely to just focus more intently on that category. Meanwhile, if you had a preference for packaged goods, snacks, etc., you're more likely to lean into that sort of comfort.

It's worth your time to just read this article
https://www.washingtonpost.com/business/2020/09/01/grocery-shopping-coronavirus-impact/

COVID 19, hurricanes and vacation travelers in Mexico

Hurricane activity is not limited to the Atlantic and Gulf of Mexico. While Tropical Storms Paulette and Rene have recently formed in the eastern Atlantic and the U.S. and Caribbean Islands have already had multiple hurricanes and storms make landfall, hurricane activity in the eastern Pacific along the coast of Mexico has had its share of storm development this year as well. Our PCS team along with The Association of Mexican Insurance Companies (AMIS) partnered and launched PCS Mexico in 2019 and luckily up to this point there has not been a catastrophic event in Mexico warranting a PCS Mexico catastrophe designation. However, at any point in the Atlantic/Gulf and Pacific hurricane seasons which run through November 30th, that could change at any time.

Several of our articles in prior bulletins provided insights about COVID preparation, planning and reaction to hurricanes in the U.S., Canada and Japan. Mexico has a significant challenge that its leaders, residents and foreign vacationers would face if a storm does cause significant damages. Currently, thousands of travelers are already enjoying uncrowded, relaxed vacations in Mexico's popular beach destinations such as Los Cabos, Puerto Vallarta, and Cancún as the COVID-19 situation evolves.

Although the United States' Travel Advisory for Mexico is at "Level 4 - Do not travel to Mexico due to COVID-19", many Americans and U.S. residents have traveled to Mexico for recreation. However, not all Mexico is listed as not to travel. The US Travel Advisory page for Mexico says several tourist destinations are safer to travel and even there are no restrictions on travel for U.S. government employees in Baja California Sur, which includes tourist areas Cabo San Lucas, San Jose del Cabo, La Paz and in Quintana Roo state, which includes tourist areas Cancun, Cozumel, Isla Mujeres, Playa del Carmen, Tulum, and the Riviera Maya.

The risk is on both sides of the coin with just as much if not more concern about U.S. travelers spreading the virus abroad in this case as the U.S leads the world in COVID-19 infections. Since March 21st, travelers can't drive to Mexico from the US via any of the land crossings, and governments of both countries extended the agreement to close the land borders to nonessential travel until September 21st. However, there are currently no restrictions on flying into Mexico. Commercial flights are operating to and from Mexico. Hotels and restaurants are open since June however bars and nightclubs have not yet reopened.

Two weeks ago, Hurricane Genevieve was approaching the Baja Peninsula of Mexico which has many tourist resorts. Genevieve had a been a powerful Category 4 hurricane with winds of 130 mph (215 kph). Fortunately, Hurricane Genevieve weakened to a tropical storm lashing Mexico's Los Cabos tourist resorts with hurricane-force gusts and heavy rains. The storm knocked out power and phone service to a large part of the Los Cabos area, flooded streets in neighborhoods and toppled palms in the tourist zone. During the early morning hours, the fire department received multiple calls to rescue people from cars surrounded by floodwaters and from inundated homes. Los Cabos Mayor Armida Castro said more than 800 people had gone to shelters in Cabo San Lucas and another 250 in San Jose del Cabo, where social distancing measures were in place due to COVID-19. Additionally, Mayor Guzmán stated that the shelters were staffed with medical personnel and there were locations to isolate COVID-19 positive or suspected cases. Baja California Sur state officials said 15,000 foreign tourists were in the state, most in the Los Cabos region, which earlier had almost been emptied of visitors by pandemic restrictions. Hotel occupancy was at 20%. Some 80,000 homes were without power in the aftermath of the storm, and many neighborhoods are still without power and water.

Although this hurricane season has been active, no major cities or metropolitan areas have been catastrophically affected thus far. Social distancing, mitigation and containment processes have yet to be fully stress tested during a major hurricane affecting a densely populated city in which unfortunately if the processes and plans are inadequate, the risk for additional SRCC activity may escalate.

Panel Discussion on COVID-19 and Risk Transfer

PCS's Tom Johansmeyer was fortunate enough to be invited to participate in the annual Munich Re Monte Carlo panel, which was virtual this year. We encourage you to check it out at https://event.on24.com/wcc/r/2560263/1501582E5FBB4DE1431574CFAEB7BEF5. There are some excellent discussions on the impact of COVID-19 on the market, pandemic parametrics, and a wide range of other issues. If there's anything you'd like to discuss with PCS in detail, we'd love to hear from you!