PCS Information Bulletin #24: COVID-19 Review

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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.

Will a Fundamental Change in Retailer Strategy Have to Come?

The COVID-19 pandemic has affected the retail sector disproportionately, especially non-essential categories. Some amount of near-term inventiveness may help the sector continue to operate – and potentially even slow the financial bleeding – but a reevaluation of the industry's conventional wisdom may be necessary over the next several years.

The past 20 years have forced retailers to find unique ways to differentiate themselves from online competitors. The convenience of online shopping quickly developed into an existential threat for "brick and mortar" shops, and the latter had few levers to pull against a consumer experience that required no physical movement. As a result, the "retail experience" became the sector's primary approach to survival in the face of threats from behemoths such as Amazon. A web browser can't deliver high-touch service, the advice of a store employee, or the soft music validated by countless focus groups.

As part of the evolution of the retail experience strategy, the tangible aspects of having the consumer in the store were emphasized. Customers could feel fabric, try on clothing, see the brightness of a lamp, and test the comfort of a couch or mattress. Think of dozens of customers a day trying on the same shirt, sitting on the same easy chair, or lacing up the same pair of shoes.

To encourage the tangible advantages of in-store shopping, retailers kept as much merchandise on the floor as possible. Customers could paw through several pairs of jeans to find the right size. Books were packed into shelves to help customers see as much as possible, and take a few in hand to peruse while making a decision.

All without the benefit of hand sanitizer stations at the end of every aisle.

Of course, the historical approach to engaging the customer in the store and using tactile temptation to increase basket size (i.e., the total amount of a customer's spend per visit) is unlikely to be as effective in the age of COVID-19 as it had been before.

Caps on the number of customers in a store at any given time become a natural constraint on foot traffic, which affects the output of a formula that starts with people walking by the front door and follows the funnel down through entry, time in store, and conversion. Simply not being able to get as many people in the store every day inherently limits the amount of purchasing possible, even if customers use fewer trips to buy more goods.

Once inside the store, of course, many customers may have reservations about tactile activity. Masks, hand sanitizer, and gloves provide a stark reminder of the fact that disease transmission is a battle to be fought, and gratuitous touching has been discouraged by nearly every authoritative organization in the world. Touching and trying are unlikely to disappear from the retail experience, but frequency and intensity should probably be impacted.

The current economic climate – a natural outcome of the pandemic – remains a challenge for the retail sector. Even as businesses reopen with some amount of planned longevity (i.e., after the pervasive threat of having to close again has subsided) and people return to work, the attendant financial security that allows people to shop again recreationally may not solve the problems faced by the retail sector. Discretionary income is only one part of the process that gets consumers to spend. The process by which prospective buyers attracted to a store, encouraged to enter, and primed to increase their baskets may have to be rethought entirely. While the days of the tactile retail experience may not be gone for good, they're certainly reduced for now.

Would Government Response Be Better Next Time?

In several conversations with PCS clients and market stakeholders, this question has arisen, particularly within the context of pandemic risk transfer. There's a certain optimism across the market – rare among professional skeptics – that governments will learn from the COVID-19 experience. And as a result, in the future, they'll be faster to:

1. Identify the early signs of a pandemic
2. Designate events of significance
3. Implement protective or mitigating measures to address the spread of the virus
4. Develop economic measures to blunt the effects of the pandemic on society

Meanwhile, none of us has forgotten that the human condition often favors instant gratification over near-term sacrifice, which can limit our ability to learn from our mistakes.

The conventional thinking is fairly straightforward. When the next major pandemic strikes, governments will look back on COVID-19 and use that as justification to get citizens to accept the imposition of necessary limits on personal freedom in order to reduce the impact of the pandemic on society. To make this assumption, however, is to forget the role political risk can play in the risk transfer process.

Let's take a look at the United States. The resurgence in COVID-19 infections was driven at least in part by politically motivated decisions to accelerate business reopenings. With this in mind, how could future government leaders be expected to address a pandemic? The answer isn't a simple "yes" or "no." The party in power would have an impact over the course taken, and overall sentiment in the country about elected officials would contribute to whether there's pressure on politicians to follow a certain course or if citizens became apologists for those in office with views similar to their own.

Risk-transfer instruments developed to address the pandemic may rely on government-provided event designations or civil orders to close businesses. In extreme cases, though, such activity may not come, which could result in a more rapid spike of case transmission or fatalities, ultimately leading to more severe economic consequences faster. For such instruments, a non-governmental backup designation facility could help reduce both political risk and basis risk.

Case Counts versus Fatality Counts: Does the Resurgence Suggest Basis Risk?

Case counts have increased aggressively across the United States over the past three weeks. The top ten states for reported COVID-19 cases, according to Worldometers.info aggregated data, represent an astounding sixty percent of total U.S. cases reported so far – and that includes the March/April wave and all recovered cases. However, fatalities have not maintained the same pace.

[NEED A TABLE – TOP TEN STATES FOR OPEN CASES RIGHT NOW]

State	Open COVID-19 Cases	Total COVID-19 Cases
New York	274,852	422,268
California	188,092	264,832
Florida	174,265	206,447
Texas	97,433	200,952
New Jersey	103,445	176,967
Illinois	27,873	148,373
Massachusetts	8,634	109,974
Arizona	88,412	101,441
Georgia	79,361	95,516
Pennsylvania	17,546	94,437

Sources: Worldometers.info, PCS internal research

Several mitigating factors have been identified to account for the apparent lower COVID-19 fatality rate this summer, including the notion that a larger proportion of the infected population is younger than back in March and April. However, such theories need to be counterbalanced against the possibility that it's just too soon to tell right now. The lag from reported cases to fatalities could reach four weeks, and this development remains clouded by uncertainty. For example, there's the belief that fatalities among younger cases should not be nearly as high as in older cases. New strains, different socioeconomic conditions, and other factors could result in a change, though – not to mention risks associated with overwhelmed healthcare systems, should that materialize again.

For the re/insurance community, the lack of fatalities from the recent resurgence – or lag in fatalities, should they come in a few weeks – introduces a fresh discussion about basis risk. Reported case data can be notoriously unreliable and volatile, although cases are more reflective of the impact on economic activity than fatalities. Fatality data, however, is easier to manage. Economic impact from increased cases without an attendant increase in fatalities – particularly if affected by civil orders to close businesses – could result in the potential for insured loss that would not trigger fatality-focused parametric transactions.

For now, there's no action – only waiting. If an attendant increases in fatalities comes, then the industry can adjust future pandemic parametric transactions to account for a lag in fatalities relative to reported cases (particularly through wordings that could allow an extension of the agreement in the event that there is a spike in cases of a certain size within the last 30/60/90 days of the risk period). Absent the materialization of fatalities based on the latest increase in reported cases, a risk-transfer instrument would need to address such factors in the risk analysis and then develop the appropriate wordings.