

## **PCS Information Bulletin #27: COVID-19 Review**

***Wednesday, July 29, 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.

### **Pandemic Parametrics: Should Your Backup Trigger Become Your Primary?**

It wasn't permanent, but the fact that it happened at all is cause for alarm. COVID-19 data was temporarily removed from the CDC's website (<https://www.washingtonpost.com/health/2020/07/16/coronavirus-hospitalization-data-outcry/>). The fact that it's back online solves the immediate problem of data availability, but it does little to address the longer-term political risks and potential problems associated with transaction reliability. So, now may be the time to rethink how you would structure pandemic parametric ILWs – and maybe turn your back up trigger language into your primary trigger.

For those of you not actively engaged in the ILW market, here's some context. Industry loss warranties (ILWs) are alternative forms of reinsurance cover where a claim is paid based on an independent, third-party data source's reporting rather than a cedent's own loss experience. Most ILWs are for U.S./North American natural catastrophe risk. PCS is the trigger for those, which explains our overall interest in the ILW market. Japan is probably the next-largest market, with the overwhelming majority of instruments using PCS Japan/APAC. Outside the traditional property-catastrophe space, there are parametric ILWs that trigger based on an independent measure of the magnitude of an event. They could include: category 5 hurricane making landfall, an earthquake of a certain size as determined by USGS, or even a pandemic with a certain number of fatalities or reported cases. In fact, this last one has been a topic of frequent conversation lately.

It's not unusual for an ILW to have a provision for "trigger failure." If the reporting agent (i.e., data source) you use for a particular trade fails to report, what do you use instead? In some cases, there's a backup you could turn to. In others, it may be left to the parties to find something mutually agreeable – which we saw after Typhoon Jebi rarely works well. If you're at the point where you need a backup trigger, you can probably expect a certain amount of additional expense to be necessary in order to come to a resolution, which ultimately undermines the value of the cover.

Now, think about that issue above – the removal of COVID-19 data from the CDC website. If you had a parametric ILW for pandemic cover and referenced CDC data (which, in most times, would be considered bullet-proof), you'd need a backup. There are alternatives. One would be the WHO. The other would be an aggregation of state and local health agency data. Those alternatives have tended to diverge from the CDC throughout the COVID-19 crisis. This is due at least in part to the notion that cases are lost due to friction in the reporting process, with data going from state and local health agencies to the CDC to the WHO. With each potential alternative data source likely to appeal to a different party to a transaction, the risk of litigation to attain a resolution increases.

When a transaction is contemplated, all parties value trigger certainty and reliability. When there's a claim and even a sniff of trigger failure, all parties seem to value winning. And it makes sense. If there's a

triggering event with a robust, reliable, and accurate trigger in place, it's much more difficult to contest the outcome. For this reason, getting your trigger right up front is of paramount importance.

For this reason, particularly given the political risk we've seen manifest in COVID-19 data reporting, it may make more sense either to specify a backup trigger (and tertiary process should the backup fail) or to simply rethink the primary trigger.

The backup trigger situation could be clarified pretty easily. Let's say you have a pandemic parametric ILW that triggers on 250,000 new fatalities between October 1, 2020, and December 31, 2020 (inclusive) per the CDC. Then, CDC data disappears. You could have a backup trigger that specifies WHO data for the same threshold and time period, with a 60-day period after December 31, 2020, to pickup any lag or corrections in reporting. Failing that, you could have the parties agree to aggregate data from state and local health agencies (which still could have some room for interpretation and variation/conflict of data sources).

The alternative would be to appoint an independent reporting agency from the start of the transaction. It would look something like: a pandemic parametric ILW that triggers on 250,000 new fatalities between October 1, 2020, and December 31, 2020 (inclusive) per the PCS. PCS would then specify that our primary approach would be to aggregate from state and local health agencies, although we would consider WHO, CDC, and other sources of information as appropriate. And we would use our professional judgment in matters where there is conflict, uncertainty, ambiguity, or lack of access to data.

It looks like there's no difference between the two processes except the insertion of an independent reporting agency. That one factor, though, changes the situation significantly. First, the notion of professional judgment ensures that a result that makes sense is reached. Anomalies in the data can be accounted for. Mistakes made by end data sources can be identified. The parties to the transaction leave the tabulation and calculation of data to a third party, which leaves them unable to derail the transaction based on narrow or unintentional disclosure by end data sources.

The pandemic parametric ILW sector is still tiny, but there could be a need for this sort of cover at the next reinsurance renewal. Not developing this market could result in a missed opportunity for years to come. If our industry is ready to enter the pandemic parametric sector with scale, it'll need the support of a reliable, independent loss reporting agency with decades of experience.

### **Retail Matters: Is Now Self-Checkout's Time to Shine?**

For both retail and quick service restaurants (QSRs), checkout is probably where the risk of customer dissatisfaction reaches its peak. Sure, there's the possibility that certain items are out of stock or not carried any longer. And there are other ways the customer experience could suffer out on the retail floor. Checkout is where the risk seems highest, though.

During busier periods, lines form. And they can get long. Lines seem to form when people are in the biggest rush (like shopping after work and just wanting to get home). Customers can make mistakes or become inefficient at checkout, and the employees working the registers represent the most interaction the customer is likely to have with a human being who works at the store. Scanners may malfunction, and labels on items may not be affixed appropriately. Employees may have questions about which variety of cucumber is being purchased. And a slip of the finger can require a manager to void the entry.

Retailers and QSRs have been struggling with the point of sale for decades. Twenty years ago, QSRs were looking for ways to shed 30 seconds per customer from the checkout process – realizing that 30 seconds was “a lifetime” in that context. Consumer-facing businesses have made plenty of progress over the past two decades, although every win has been hard fought. Starbucks has used its app to enable out-of-store ordering and reducing the customer’s checkout experience to order pickup, and it seems to have been quite successful. CVS seems to have done well with self-checkout as well. Grocery-focused retailers and discount clubs have had mixed results. Some goods just don’t lend themselves to self-checkout.

Oddly, apparel and specialty retail haven’t adopted self-checkout (at least with any scale) yet. As you’ve seen in a lot of our information-only bulletins on COVID-19, we’ve talked a lot about the “retail experience,” and it seems like this is an issue again – or soon to be a legacy issue – with apparel, specialty, and other less-commoditized forms of retail.

Apparel and some forms of specialty retail can have products that lend themselves to self-checkout. Shirts and socks are easy, right? They are dry goods (have you ever struggled with meat during self-checkout?) that are easy to tag consistently. They are small and malleable, so getting the tag to the scanner isn’t difficult. And they are easy to pack. Self-checkout should be a no-brainer.

The problem is that retailers in some segments have sought to turn the highest-risk part of the in-store experience into an opportunity to increase customer satisfaction – and possibly basket size. Take apparel, for example. There are always friendly questions about whether or not you found everything you needed – likely earnest questions, given the opportunity to increase basket size. You may get information about how garments should fit. And of course, there’s that last chance for cross-selling and up-selling, to include the standard pitch for a store credit card.

Risking speed and customer satisfaction can be worth it for the opportunity to increase basket size, pitch loyalty programs, and win customer data. While some of that could be automated, the results would probably be less compelling.

COVID-19 calls this entire process into question. As retailer and QSR priorities change, strategies will have to evolve. To manage the risk of infection – which could become a prerequisite to staying open – retailers need to contemplate how to:

1. Push customers through the store faster
2. Make inventory look appealing while minimizing touching
3. Adjust for liberalization in return policy in exchange for minimizing use of the fitting room
4. Reduce the number of employee touchpoints
5. Move some in-store solicitations to online or other channels off the floor

Much of what was used to lure a customer into the store and keep her or him there may have to be pushed back outside the store in order to increase the viability of the brick-and-mortar experience. That makes sense until you think about what drove the increased investment in the in-store experience: competition from online outlets. In-store risk mitigation could result in a near-term inability to differentiate sufficiently from online, which could lead to a loss of opportunity – and another round of the soul searching that retailers had to engage in 30 years ago.

## **Status of the US consumer credit card market**

We've talked a lot in the last few months about the economic strain that COVID-19 will bring to the consumer market and now, we are starting to see the first signs. Credit card companies are starting to minimize their exposure to the potential hardship period to come by closing credit card accounts and lowering credit limits.

According to a report from CompareCards.com that surveyed 1,003 credit cardholders, one in four Americans with credit cards said they had an account involuntarily shut down from mid-May to mid-July, while one in three said their credit limit was reduced. While these measures can be implemented without prior notice from the credit card companies, most of the people affected reportedly received notifications. And account inactivity was reportedly the reason for account closure in approximately 25 percent of cases.

Banks are taking an even harder stance on lending at present because of elevated near-term uncertainty – including public health, economic, and political factors. The pullback among credit card issuers is occurring more frequently than during the “Great Recession” in 2018, when one in six cardholders reported reduced limits or involuntary account closures, according to a 2010 study by Phoenix Synergistics, a market research firm for financial services companies.

Americans making more than \$100,000 were the most likely to have their credit limit cut. Two in five reported that happened to them. While most credit limits were reduced by \$1,000 or less, more than one in five cardholders said their limits were slashed by at least \$5,000.

Young millennials were the most likely to be affected among the generations, the report found. Four in nine young millennials, currently between the age of twenty-four and thirty-one, had a card closed, while five in nine had their credit limit reduced. At the same time, credit card companies are reviewing the benefits and rewards offered and trying to adjust these incentives to accommodate the current environment.

This reduction in limit or close-out of cards will have a material impact on the credit score of Americans, with increased utilization rates which will lower credit scores. Overall, this all means a decrease in the spending limits of the average consumer while also making it more difficult for them to get a mortgage or take advantage of the current lower rates as the down payments for long term loans would have to be bigger. The long-term economic effects thus could be profound, ultimately impacting housing prices (and thus insured values) for years to come.

In the near term, reduced access to credit could further constrain consumer spending, which elongates the current economic malaise and could delay a recovery. In fact, the implications of tighter lending could become significant during the holiday season.

## **The Cost of COVID-19**

It's going to be difficult for the global re/insurance industry to understand the overall loss from COVID-19. The impact will span lines of business and jurisdictions. For claims in some classes – such as D&O – it could take years for the full effect to be understood. Across the sector, current estimates for the projected ultimate loss range from as little as US\$30 billion to more than US\$100 billion. A few have settled around the middle at the US\$50-70 billion range, which according to some PCS internal research, seems like a reasonable enough spot for now.

Of course, PCS does not have an industry loss estimate for COVID-19, and we do not intend to publish one. Further, we have not designated COVID-19 a catastrophe event in the United States or in any of the other regions where we report property-catastrophe losses. We leave room for the possibility that COVID-19 losses could appear in some of our non-catastrophe/specialty lines loss reporting platforms, but that hasn't happened yet.

A recent ReinsuranceNe.ws tally of losses related to COVID-19 does provide some insight into how the overall loss could evolve (<https://www.reinsurancene.ws/covid-19-insurer-reinsurer-loss-reports/>). The list of disclosed losses by company reaches US\$20.5 billion. Of course, this isn't an exact science. There could be some duplication in there or other issues. And there's plenty of IBNR in there. However, it's among the best efforts we've seen so far, particularly so early in the development of the pandemic.

The list is not comprehensive, but it certainly provides some indication of the direction of the loss. At US\$20.5 billion today, it seems like estimates as low as US\$30 billion may be optimistic. That said, losses don't necessarily have to develop upward over time. Particularly with larger specialty losses and those with complex circumstances, there can be volatility in both directions. PCS has seen this regularly in marine and energy, large onshore risk losses, and cyber. It can even happen in the property-catastrophe space (Typhoon Jebi is a great example).

## **COVID and the first U.S. hurricane landfall of the 2020 season**

In our PCS COVID Informational Bulletin number 23 we talked about COVID-19 cases spiking in hurricane prone states in which Texas was one of the subjects of that piece. Following that, in our COVID Informational Bulletin number 25 we explored COVID Impact at the county level for several states that have been most significantly affected with COVID cases in which again Texas was one of the top three states in the US impacted by COVID. In fact, as of the latest COVID-19 data related to Texas, the state has surpassed 400,000 confirmed cases and over 6000 deaths.

Continuing with a trend of early season tropical events, Hanna developed quickly in the gulf last week. On the evening of July 22nd, it was a low-pressure system in the middle of the Gulf of Mexico and was named Tropical Depression Eight. After several days of quick development, by the morning hours on July 24th, Tropical Storm Hanna was located about 260 miles east of Corpus Christi, TX with maximum sustained winds of 45 mph. Hanna continued to strengthen through that day and as of the morning of July 25th, Hanna was upgraded to a category one hurricane, with maximum sustained winds of 75 mph. Hanna continued to strengthen as it approached the Texas coast and by late afternoon, Hanna made landfall along Padre Island with maximum sustained winds of 90 mph.

Less than an hour before Hanna's landing Saturday, Texas Governor Greg Abbott asked residents not to forget the pre-existing threat of COVID-19 in the face of the natural disaster. According to The Texas Tribune, Abbott announced that the state's emergency response would include 17 COVID-19 mobile testing teams focused on shelters and 100 medical personnel provided by the Texas National Guard. For people who elected leave the area, the American Red Cross provided hotel vouchers when they arrived at the San Antonio's Freeman Coliseum which was used as a welcome center for evacuees from the far southern Texas counties. The governor also issued a disaster declaration for 32 counties and a federal emergency disaster declaration request. Gov. Greg Abbott said the state was sending additional testing supplies and hospital personnel to South Texas communities impacted by Hanna to ensure the storm doesn't exacerbate the spread of the virus.

"The spread of COVID can be far more deadly than the damage caused by the storm," Governor Abbot is quoted as saying. He planned to tour damaged areas Tuesday July 28<sup>th</sup>.

The governor asked residents to adhere to social distancing guidelines and to wear masks if they had to leave their homes and go to a shelter. Officials said shelters were set up to be as safe as possible, with temperature checks by on-site medical personnel. Some were being sheltered in hotel rooms. Border communities hit by Hanna were already strained by COVID-19 cases — with some patients being airlifted to larger cities.

The Texas area struck by Hanna has struggled to contain outbreaks of COVID-19 in recent weeks. Cases along the state's coast have soared into the tens of thousands, and more than 400 people in Corpus Christi's city of 325,000 were hospitalized with the novel coronavirus on Friday, according to city data. Corpus Christi Mayor Joe McComb warned residents who live in flood-prone areas to heed coronavirus precautions when deciding to evacuate. "Take several masks with you because you might be there a couple days if you're in a flood area," McComb is quoted as stating. "We don't want to expose anyone during this storm. Even when you're in the house, I recommend wearing a mask if you're in crowded conditions."

In the aftermath of Hanna, which dumped up to 16 inches of rain in some parts of South Texas and Northern Mexico, officials reported two people died in the northern Mexican city of Ramos Arispe, near Monterrey, after torrents of water unleashed by Hanna swept their vehicle away. Three people were reported missing in Monterrey and three more were missing in the border city of Reynosa, across from McAllen, Texas, according to Mexico's national civil defense office. While Hanna was designated as a catastrophe for the US, the extent of damages reported in Mexico at this time have not warranted a PCS Mexico catastrophe designation.

While Hanna and the damages it has caused, and the further risk of spread of COVID-19 that it may have generated for the south Texas communities is unfortunate and undesirable, the take-away from this event is that it is a microcosm of what could happen if and when a major storm makes landfall near major population centers or affects multiple states. Several areas of concern for insurers and reinsurers if and when major metro areas are affected during the COVID-19 pandemic will be on display; increased costs associated with Additional Living Expenses due to shortages with lodging and increased costs due to the surge demand, concerns of increased mitigation, remediation and reconstruction costs resulting from labor shortages due to demand and COVID-19's effect on the workforce.

## Upcoming PCS Webinar

Over the past couple months, a lot of discussions we've had about COVID-19 and silent cyber have centered around implications for pricing, exposure management, and, importantly in this environment, capital modelling. Join us on Friday, August 7, for [Silent Cyber Webinar – Useful tools to challenge your understanding](#) when we'll continue the conversation and spend some time talking about how to assess your cyber exposure from both your cyber and non-cyber policies — and what you can do to manage it. We're excited to be joined by Simon Cartagena, actuary and risk manager, SCOR UK and Channel Syndicate; Visesh Gosrani, director, Cydelta; and Jasvir Grewal, actuary, Arcus 1856.