

PCS Information Bulletin #8: COVID-19 Review

Monday April 6, 2020

Due to continued client demand, PCS has decided to publish further bulletins regarding COVID-19. This report is for information 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. The information below comes from public sources.

We understand that this is a time of significant uncertainty. If you have any questions about our thoughts above – or about the PCS catastrophe designation process – please contact Tom Johansmeyer using the information found at the end of this information-only bulletin.

Implications of State-Level Legislation for ILW Hedging

If you haven't read Dr. Bob Hartwig's interview with in the *Royal Gazette* yet, do so now and come back to this bulletin afterward (<http://mobile.royalgazette.com/re-insurance/article/20200326/insurers-face-business-interruption-battle&template=mobileart>). Among the important issues discussed is the risk that state legislatures would require that insurers honor business interruption claims for smaller companies without any attendant physical damage. It's an issue PCS has discussed frequently in these bulletins and remains, of course, the most frequently discussed question in the property-catastrophe community today (and for the foreseeable future). It could lead to the largest loss in the history of the industry, according to Dr. Hartwig.

Now, it may sound like the problem is too big to hedge, but that may not necessarily be true. What he lays out is the worst-case scenario, and there is a wide range of outcomes beneath that. It may be worth hedging those lesser scenarios on the assumption that (a) in the worst case, the industry would be devastated and nothing would matter anyway and (b) in anything except the worst case, the efforts you make now could make a significant difference.

There could be several challenges associated with developing an ILW hedge for this scenario. First, you'd need to think about whether you'd hedge all 50 states or just those where the legislative risk seems worst right now (e.g., Ohio, Massachusetts, New Jersey). Additionally, you'd need to figure out a trigger level based on the states selected. It would need to be high enough to be sufficiently remote that markets would still want to provide the cover. As to the amount of protection, it seems that we're heading toward a "just take what you can get" environment, particularly with the competing pressures for capital that already exist (such as post-Japan ILW needs and those soon coming for Florida). Finally, you'd need to decide whether it would reference the commercial portion of the PCS estimate only.

Such a hedge would seem like a drop in the bucket relative to the risk available, but that's only in relation to the worst-case scenario that Dr. Hartwig presented. Remember that there are degrees of agony before reaching that point, and in many cases, some amount of reinsurance/ILW recovery could be relevant.

How Many Claims Is Significant?

In the PCS criteria for catastrophe designation, we've always had to emphasize that the monetary threshold (US\$25 million) isn't the only factor. We also require that a significant number of insurers and insureds be affected. This is an area left to our judgment, and the reason for that flexibility could be upon us.

Historically, PCS has viewed "significant" within the context of the usual catastrophes that can get big: tornado/hail, earthquake, and tropical storm coming to mind first. When you look at the historical PCS record, you can see that they all have a significant personal lines component. Occasionally, it's predominately auto – like the flooding event that inundated Louisiana, PCS Catastrophe Number 1644 from 2016. Usually, there is a significant number of claims across all three classes of business: personal, auto, and commercial. And that has tended to inform our perspective on "significant."

If COVID-19 were to be designated a catastrophe, the context would be different from anything we've seen in the 1,800+ events in the PCS U.S. database. There haven't been any catastrophes yet that were overwhelmingly commercial regarding number of claims. While we have not designated COVID-19 a catastrophe – and will stick to our methodology as we always do – we are monitoring the situation closely.

With traditional catastrophes, we have tended to view "significant" for insureds affected to be in the thousands of estimated claims rather than hundreds. We don't think that amount of scale would necessarily translate to a commercial-only (or otherwise predominately commercial) catastrophe. We would likely look for several hundred claims and factor in how they are distributed across different states.

We do want to bring up a few potential outcomes that the market may not be thinking about. The first comes from a look at public reporting on the Oceana Grill situation in Louisiana, where reports say there isn't an infectious disease exclusion (*always take press reports with a grain of salt, particularly where one side provides information and the other declines to comment – by definition, that's only half the story*). There could be several similar cases out there like this, which could accumulate and contribute to an insured loss that meets the PCS threshold, regardless of whether there's legislative action regarding an obligation to pay BI regardless of whether the PD conditions are satisfied. There's no indication right now of any amount of scale for this situation, but PCS will continue to monitor.

The other class of property claims that could contribute to an outsized commercial loss in a PCS estimate would be large commercial losses. A handful of them each above US\$200 million (which is conceivable if the silent cyber impact on the market in 2017 as a result of NotPetya) could disproportionately impact an insured loss result. Such an outcome wouldn't be sufficient to drive a PCS catastrophe designation, but it could drive losses profoundly higher.

Let's consider a situation that involves both a handful of large risk losses and several cases like Oceana Grill. That could lead to potentially tens – rather than hundreds – of claims, but with an industry loss impact of well over US\$1 billion. Now, let's assume that there's sufficient small claims activity (commercial) to warrant a catastrophe designation. **In this hypothetical situation**, let's assume 500

claims with an average loss of \$500,000. That would translate to an industry loss of \$250 million – before adding in the larger losses. With the large risk loss situation included, the overall industry loss could wind up being five times (in this example, or perhaps much more) higher than expected based on the majority of projected claims.

Again, we're talking about hypothetical situations and are working with a paucity of data, given how early we are in the COVID-19 pandemic. PCS encourages further analysis across the market, with the understanding that the situation remains fluid.

Our thinking is early and evolving, and COVID-19 has not been designated a PCS catastrophe yet. We will continue to evaluate the situation and update the market as appropriate.

It's Time to Talk about SRCC

There's a potentially major risk to property-catastrophe programs out there from COVID-19. And the market isn't spending enough time talking about it. Strike, riot, civil commotion (SRCC). Maybe it's not top of mind because the riots in Chile last year – despite affecting the reinsurance market – didn't occur in a country that's currently a pandemic hot spot? Whatever the reason for the seemingly missed connection, it's time for the global re/insurance community to invest some time in this risk.

When people lose their jobs, are unsure of whether they'll be able to feed their families, lose trust in their governments, or otherwise experience fear, SRCC becomes a threat. While it hasn't happened with scale yet, recent events in Sicily give a sense of the near-term effects of SRCC (damage to property, shortage of goods, lost revenues) and the long-term implications (the rise of organized crime to fill the gaps left by government officials and institutions).

As of Sunday morning, ten countries have more than 20,000 reported COVID-19 cases each – with the United States at more than 300,000 and China's approximately 80,000 believed to be much higher. In the United States, New York would be the world's fifth-most affected country, with 90,000 reported cases. New Jersey would also be a top-ten country. In all, 11 states have more than 5,000 reported cases, and several are close to 10,000 (and may be there by the time we publish this bulletin).

Several of the top ten countries have had different forms of civil unrest in the past few years. In addition to the recent activity due to COVID-19 in Italy, France had a wave of protests last year (*gilets jaunes*), and Turkey experienced terror-related difficulties in 2016 (which resulted in one of the largest insured losses in the market's history, according to PCS Turkey data). Germany experienced some terror and unrest in recent years, although on a smaller scale than what was seen in Turkey and France. Waves of nationalism and divisiveness in major countries around the world, stoked by pandemic-related fears, could contribute to the risk of SRCC activity in countries with large immigrant communities (where trust in government institutions immigrant communities or – of insular communities by the existing population). When trust breaks down, the risk of civil disorder increases.

In Italy, it has been reported that organized crime has involved the use of private Facebook groups to stoke civil unrest (<https://www.thedailybeast.com/the-mafias-using-the-italy-lockdown-to-raise-hell-and-recruit>). It's a classic destabilization move, in which the population is moved to unrest as a way to delegitimize those in power. Those responsible for inciting the digital mob stand to benefit by bringing

order to the chaos they create, and in doing so securing the loyalty of the very people they put at risk. Where social media has been allegedly used to compromise elections, the risk of similar destabilization has been well established (although the end game may not involve filling the power vacuum locally so much as benefitting from the chaos on a global scale).

If you're looking for deeper and more comprehensive analysis of the factors contributing to SRCC risk, you should probably check out the indices and publications produced by our sister company, Verisk Maplecroft (<http://www.maplecroft.com>). Their team does this for a living, and PCS routinely consumes Verisk Maplecroft material when learning about events around the world. Additionally, we publish select Verisk Maplecroft data in our PCS Global Large Loss and PCS Global Terror loss reporting platforms.

So, what's at stake with SRCC?

There's obviously the human impact, which just compounds tragedy upon tragedy. While we feel the need to acknowledge this, for the purposes of re/insurance industry impact, though, we don't need to explore it in detail. Other resources are more appropriate to that effort.

More immediate to our community is the potential for insured losses. As we saw last year in Chile, SRCC can lead to sizeable industrywide insured losses, particularly when both smaller insureds and large programs are affected. According to PCS LatAm estimates, between one third and one half of the industrywide insured loss is from a handful of retailers.

For COVID-19, SRCC could result in the physical damage (PD) necessary to trigger some property insurance programs (depending on wordings, of course), which in turn could lead to the large business interruption (BI) implications that have been the talk (and overarching concern) of the industry for the past few months. In such a scenario, "silent pandemic" in the sense we've explored wouldn't be the cause of PD being affected. And, it wouldn't require legislative activity to "satisfy" the PD portion. Rather, where SRCC is included (or at least not excluded), any PD from the wide civil disorder spectrum would engage the property program.

The scale wouldn't be as massive as the legislative scenario for smaller programs, but it could engage larger programs more broadly, which could conceivably run up the industry loss without requiring a commensurate number of insureds compared to the catastrophe scenarios most often contemplated. Additionally, it would lead to catastrophe losses, which could then have implications for reinsurance and retro covers.

While the scale wouldn't be as great as it would be for some of the other property scenarios contemplated in the market (like compromising PD in smaller policies), SRCC could become quite large when taken on a global basis. And, as some countries experience high rates of infection (e.g., Italy and Spain), countries not yet affected could experience pressure strictly from the fear that they'll be next, may have higher rates of infection, and so on. So, the significant presence of the pandemic in one country could conceivably increase SRCC risk in another. As a result, SRCC could become a global risk, with the prospect increasing globally alongside the global rate of infection.

Now, this is purely speculative, but the fact that this could occur should be sufficient to encourage some analytical effort among underwriters and portfolio managers with SRCC exposure in major markets. And

such analysis should be communicated to claims teams so they can prepare for the possibility of an influx of claims on a peril that they may not have to consider all that often. PCS will continue to monitor for SRCC risk and would designate such an event as a catastrophe in accordance with our methodology. PCS reports on catastrophes in the following regions: North and South America, Asia-Pacific, and Turkey. We realize that for a worldwide risk-transfer transaction – or some subsets, like G-20 – there is insufficient reporting agency coverage for an ILW. We might be able to implement bespoke reporting solutions where needed to fill the reporting agency gaps necessary to complete such trades. Please contact Tom Johansmeyer at tjohansmeyer@verisk.com /+1 441 799 0009 (Atlantic Daylight Time, but flexible in working across time zones with enough notice) if you need to explore this concept further.

Useful Links from COVID-19 Data Sources

- US Government Federal Guidance - <https://www.usa.gov/coronavirus>
- Government of Canada Federal Guidance - <https://www.canada.ca/en/public-health/services/diseases/coronavirus-disease-covid-19.html>
- UK Government Guidance- <https://www.gov.uk/government/topical-events/coronavirus-covid-19-uk-government-response>
- Government of Mexico Federal Guidance - <https://www.gob.mx/salud/documentos/nuevo-coronavirus-2019-ncov-comunicado-tecnico-diario>
- ESRI COVID-19 GIS hub: https://coronavirus-resources.esri.com/?adumkts=industry_solutions&aduse=local_state&aduc=email&adum=list&utm_Source=email&aduca=mi_smart_communities&aduco=coronavirus_hub_resources&adut=950533&adupt=awareness&sf_id=7015x000000iQIAAA2&aducp=operational_second_body_text
- WHO COVID-19 situation reports: <https://www.who.int/emergencies/diseases/novel-coronavirus-2019/situation-reports>
- CDC Overview Page: <https://www.cdc.gov/coronavirus/2019-ncov/cases-updates/summary.html> (includes links to testing locations, nature of transmission, etc.)
- Insurance Information Institute Corona Virus Toolkit - https://www.iii.org/sites/default/files/docs/pdf/covid19_toolkit_03162020.pdf
- Pharmaceutical technology Coronavirus COVID-19 outbreak: Latest news, information and updates - <https://www.pharmaceutical-technology.com/knowledge-bank/coronavirus-faqs-covid-19-categories/>
- CNN Live Coronavirus pandemic updates: <https://edition.cnn.com/world/live-news/coronavirus-outbreak-03-17-20-intl-hnk/index.html>
- Worldometers.info - <https://www.worldometers.info/coronavirus/country/us/>

- Wikipedia US pandemic - https://en.wikipedia.org/wiki/2020_coronavirus_pandemic_in_the_United_States
- European CDC - <https://www.ecdc.europa.eu/en/publications-data/download-todays-data-geographic-distribution-covid-19-cases-worldwide>
- GOV.UK - <https://www.gov.uk/guidance/coronavirus-covid-19-information-for-the-public>
- Public Health England - <https://www.arcgis.com/apps/opsdashboard/index.html#/f94c3c90da5b4e9f9a0b19484dd4bb14>
- Sante Public FR - weekly update - <https://www.santepubliquefrance.fr/maladies-et-traumatismes/maladies-et-infections-respiratoires/infection-a-coronavirus/articles/infection-au-nouveau-coronavirus-sars-cov-2-covid-19-france-et-monde>
- GOV of Canada - https://www.canada.ca/en/public-health/services/diseases/2019-novel-coronavirus-infection.html?utm_campaign=not-applicable&utm_medium=vanity-url&utm_source=canada-ca_coronavirus#a1
- MorgenPost.DE - <https://interaktiv.morgenpost.de/corona-virus-karte-infektionen-deutschland-weltweit/>
- Robert Koch Institute - https://www.rki.de/DE/Content/InfAZ/N/Neuartiges_Coronavirus/Fallzahlen.html

If you have information that could be useful to PCS or the industry and would like to share it with us, please contact Tom Johansmeyer (+1 441 799 0009 / tjohansmeyer@verisk.com), Ted Gregory +1 201 253-6866 / tgregory@verisk.com), or your regular PCS contact. We'd be happy to connect with you. All information supplied will be held in the strictest confidence and only be used to inform industry-wide analysis that is fully anonymized.