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Chilean Riots: Retail Industry Insurance Impact

The riots that broke out across Santiago, Chile, from October 7 to December 16, 2019, resulted in significant economic losses and the largest insurance industry loss since the Chilean earthquake of February 2015. Insurers and reinsurers have been affected, and the loss continues to develop. Unsurprisingly, a large portion of the insured loss from the event is large commercial. In particular, the retail sector was impacted profoundly. Two retail losses account for nearly a third of the PCS® current industry loss estimate for the catastrophe, and as information about the event continues to emerge, we could see the retail sector accounting for even more.

The Chilean Retail Sector

Five retailers operate at least 1,400 stores in Chile, according to PCS research of data from both Verisk Maplecroft™ and the *Global Powers of Retailing 2019* report produced by Deloitte. Retail revenues in the country reached approximately US$17.2 billion in 2018, the last year for which estimates are available. With the exception of Walmart, the country's major retailers tend to be regional players, with each company represented in at least two other Latin American countries. Walmart appears to be the only global powerhouse with significant operations in the country. According to the Deloitte report, only one of the top 20 global retailers is present in Chile, and none has the local scale that Walmart does.

Retail Sector Profile: Chile

Retailer	Number of Stores (approx.)	Market Share in Chile as of 2018
Walmart	380	42%
Cencosud	360	28.1%
SMU	300	21.4%
Falabella	70	4%
Montserrat	35	< 5%

Sources: PCS internal research, Verisk Maplecroft, Deloitte

Latin America had only 11 retailers in the top 250 in fiscal year 2018, according to Deloitte, with average revenue of US$7.9 billion. The region led the world in retail revenue growth that year, at 5.3 percent. Retailers in the region focused mainly on their home country, operating in just 2.5 countries on average and generating nearly 80 percent of their revenue from their domestic markets. The growth of retailing in the region continued to be driven by consumer demand for convenience, with increasing Internet penetration providing a further boost to e-commerce, and the adoption of omni-channel strategies by companies. Consumer confidence increased, with GDP rising in all countries in the region.

Chile is the largest market for U.S. consumer food exports in South America, according to a USDA Foreign Agriculture Service report. The 2018 total of consumer food exports to Chile grew 6 percent to US$669 million, a new record. Chile is also the second largest market in South America for U.S. processed food product exports, at US$495.4 million—up 15 percent from the same period in the prior year, also a new record level.

The retail sector in Chile is clearly large and significant. Further, the "soft target" nature of retail establishments worldwide contributed to their vulnerability as insureds during the 2019 riots. As a result, the five largest retailers in the country were directly affected by the riots. Specific loss details vary across the retailers.

Walmart: Around 20 stores were burned to the ground and many others were affected by vandalism and looting according to news reports. As a result, PCS estimates an insured loss of US$500 million, which exhausts the relevant program.

SMU: Nearly 150 stores have been ransacked and 14 burned (out of the total 510 locations), including malls and small shops. So far, PCS understands the insured loss to be north of US$140 million.

Falabella: 49 stores have been affected (so far, as reported), with 25 Tottus supermarkets, 20 Sodimac, and four Falabella stores. PCS believes the insured loss to be below coverage limits of US$100 million.

Cencosud: Cencosud and its subsidiaries Jumbo, Santa Isabel, Paris, Easy, and Johnson had 78 stores affected, 24 with extensive damage and five destroyed nationwide. About 30% of their branches were closed from October 24, 2018, with a total impact of 2% of estimated sales nationwide. The insured loss appears to be within the company's estimated US$100 million in coverage limits.

Other retailers: PCS continues to research insured losses to Latin American retailers, with the understanding that the London market is bearing a meaningful share of them. Based on current information, PCS believes the insured loss to major retailers from the riots to be below US$1 billion, with the assumption that there are further facultative losses to be identified. PCS has identified nearly US$900 million in specific retailer insured losses, and not all affected programs are total losses. Thus, it's important to continue to monitor for loss creep.

The Problem beyond the Riots

The insured losses from the 2019 riots do highlight some industry issues to be resolved. Some reinsurers were exposed to the riots through catastrophe programs that may not have contemplated (explicitly) man-made risks. Broad exposure to retail in Latin America could also result in disproportionate loss activity. For the industry as a whole, though, the need to insure soft-target strike, riot, and civil commotion (SRCC) risk, along with terror, warrants some attention. It may be difficult to secure sufficient coverage for such risks at each link in the risk and capital supply chain, making alternative sources of capital and forms of protection crucial to effective risk and capital management.

For the end insured, parametric insurance could be particularly effective. A combination of parameters could help quantify the conditions of loss to the point that modelers would be able to understand how much protection they need and manage basis risk effectively. Key retail parameters for such protection could include:

Revenue loss: To be most effective, revenue per day throughout a catastrophe period would vary based on season to include key holidays by country covered. In the United States, for example, retail activity in December is much different from July. An event in October could have a chilling effect on subsequent months' sales, which would be akin to degraded, rather than devastated, performance. Where possible, day of week should be factored in as well, with the understanding that weekends may have higher revenues than weekdays. In general, a parametric cover should contemplate the rhythms of the underlying business.

Foot traffic: People translate to sales in retail, and fewer people mean fewer transactions. Instead of lost sales, a reduction in foot traffic during or after an event could be used as a way to mitigate the possible misrepresentation of lost revenues or other forms of moral hazard.

Injured/wounded: Physical violence can dampen future activity with a particular retailer for long a time. If there are significant injuries, the company could be exposed to protracted news coverage. Think about the sustained business impact of large numbers of people being trampled during a riot at a retail establishment. As news sources tend toward the sensational, a single event can become a problem for months.

Of course, there's more to the potential solution than parametric commercial insurance covers. While parametrics can be effective tactically—particularly where other forms of protection aren't available—the basis risk can be a challenge. Further, a likely tendency to bias an instrument toward positive basis risk (an approach with some merit) could result in the effective overpayment for protection.

Traditional insurance capacity could benefit from improved risk and capital management for SRCC risks in the reinsurance and retro markets. The principal problem right now is that reinsurers often pick up such risks in catastrophe treaties with very little additional premium at best. The result is a disproportionate cost to hedge, as any retro expense would come out of the reinsurer's margins. For the past few years, the presence and accumulation of SRCC and terror were noteworthy but hadn't led to any significant risk-transfer activity, because of the attendant cost relative to underlying premium.

The ideal solution would seem to be to make such risks as SRCC explicit in catastrophe treaties, which would result in sufficient premium and thus the resources for risk and capital management on a targeted basis as needed. That's unlikely to occur without a market-changing event. In the near-term, broader industry loss warranty (ILW) protection may provide a stopgap solution. Rather than peril-specific ILWs—or even all natural perils—the inclusion of some man-made risks like SRCC could provide greater protection than the traditional hedges used by reinsurers.

For the 2019 Chilean riots, taken in a broader view of man-made risks, the hedge could look like a dual ILW. One trigger would include PCS LatAm—our new loss-reporting platform for Latin America—to cover SRCC and a second trigger (using PCS Global Terror) to address explicit terror risks that could also cause losses to a catastrophe portfolio.

Next Steps for the Global Reinsurance and ILS Community

Future approaches to risk and capital management are always useful, but for the riots, there are concerns that matter today. The industry needs to understand the insured loss associated with the riots and how it will develop. There should also be a flurry of activity as reinsurers check their slips to see if they're exposed to the event. Current loss estimates suggest that the riots will not cause a market-changing industry loss, but there's the likelihood that some reinsurers bearing the loss will reevaluate how they hedge at the next renewal.

Additionally, the composition of the loss should inform the next wave of reinsurer hedging strategies. The facultative market is set to bear a disproportionate share of the event's losses. Two companies currently account for almost a third of the loss, although that could change as other losses in the market develop. Even with that in mind, PCS believes that the facultative losses affecting the retail sector alone could range from US$700 million to US$1 billion, which would still be a meaningful share of the loss even if it were to creep to the highest levels being gossiped about in the reinsurance community.

The nature of the insured loss from the Chilean riots provides a unique opportunity for reinsurers to see how commercial risks could claim a greater share of the industry loss in developing markets, particularly for man-made events in metropolitan areas. The result is a new lens on how risks are covered across a portfolio—and what reinsurers can do to protect their capital.

Contact PCS

For more information, please contact:

Tom Johansmeyer | Head, PCS

Office: +1 201 337 8429 | **Mobile:** +1 441 799 0009

tjohansmeyer@verisk.com

in/tjohansmeyer

@tjohansmeyer

Alexandru Mican | Director, Specialty Lines Product Development

Office: +1 201 469 2367 | **Mobile:** +1 201 275 5674

Amican@verisk.com

in/alexandrumican

@MicanAlex