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Hurricane Florence Will Jolt Re/Insurers, But Losses Likely Will Be Manageable

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*(**Editor's Note:** As Hurricane Florence develops, S&P Global Ratings will publish additional updates.)*

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Key Takeaways

- No initial estimates of losses for Hurricane Florence (category 2) are available, but reconstructed loss estimates based on present-day risk exposure for category 3-4 hurricanes that have hit the region in the past per RMS vary between $8 billion-$20 billion.
- For losses in that range, we believe Florence will be an earnings event and not a capital event, as the combined earnings for U.S. insurance and the global reinsurance sectors will be sufficient to absorb the total year-to-date natural catastrophe losses.
- Therefore, we expect minimal rating actions, if any.
- If the rest of 2018 has as many natural catastrophes as 2017 had, re/insurers will definitely feel the pain, albeit to varying degrees.

First and foremost, as Hurricane Florence develops, S&P Global Ratings continues to hope for the safety and wellbeing of the many people who will be affected by this devastating and potentially deadly event.

Although its strength and direction could change, as per projections by the National Hurricane Center at the time of publishing, Florence (a Category 2 hurricane) is barreling toward North and South Carolina with landfall anticipated on Friday. The resulting hurricane force winds, storm surge, and potential flooding will cause material insured losses. While no initial estimates are available, RMS estimates reconstructed losses based on present-day risk exposure at $15 billion and $20.5 billion from Hurricane Hazel (South Carolina; October 1954) and Hurricane Hugo (South Carolina; September 1989), respectively; these were both Category 4 hurricanes. In light of Florence having weakened from Category 4 while approaching the U.S. east coast, a similar figure for reconstructed loss estimates is much lower for Hurricane Fran (North Carolina; September 1996), a Category 3 hurricane, at $7.6 billion.

If the insured losses from Florence are in the range of $8 billion-$20 billion, they are undoubtedly material. However, in such a scenario we anticipate Florence to be an earnings event and not a capital event for both the U.S. insurance and global reinsurance sectors. Even accounting for the estimated global insured catastrophe losses of $17 billion (per Munich Re) for the first half of 2018 and perhaps a few-to-several billion of losses from third-quarter natural catastrophes [nat cat] (such as Typhoon Jebi in Japan, the California wildfires, Tropical Storm Lane, and the flooding in Kerala [India]), we believe the combined earnings for U.S. insurance and the global reinsurance sectors will be sufficient to absorb the total year-to-date losses. Although the individual impact will vary among re/insurers, we expect the credit risk profile will be largely unchanged after this event. Therefore, we expect to take minimal rating actions, if any.

However, there is still a significant portion of the U.S. hurricane season remaining and while Florence may be within an earnings event range, to the extent the rest of the year turns out to be as active as 2017, re/insurers will definitely feel the pain--some more than others. If so, the plans of some of the reinsurers to shore up their capital positions would be challenged as 2017's nat cat losses hit global reinsurance capitalization, which for top 20 players (see note) on a combined basis dropped to below the 'AAA' confidence level. Accordingly, we'll continue to observe the accumulated catastrophe loss effect on the overall re/insurance industry and ratings.

In addition, our U.S. Public Finance team anticipates monitoring more than 50 governments within North and South Carolina and will likely expand the scope of its review to include Georgia, given the storm's recent path. S&P Global Ratings views the availability of federal grants and disaster assistance as a key component to stabilizing communities after a natural disaster, especially for areas with little-to-no support from private insurance.

Wind And Storm Surge Will Drive Losses But Increased Potential For Inland Flooding Exists

Wind-related damage and the associated storm surge are likely to be major causes of insured losses emanating from property lines, business interruption, and auto damage among others. A majority of the insured losses will likely end up with the insurance sector rather than reinsurance, given the amount of losses and prominence of national insurers in North and South Carolina and in Georgia that generally tend to retain a higher level of catastrophe losses.

As well, there's an increased risk of inland flooding from the slow-moving storm. This is because Florence is carrying an enormous amount of moisture that can lead to excessive and prolonged rain, especially as it slows down after making landfall. Although the current forecast accumulation is below that experienced during Harvey last year, when combined with topography of the region and pre-existing soil conditions due to a wet season for the east coast, anticipated rainfall increases the flood risk considerably. As a result, the National Flood Insurance Program (NFIP; a federal program covering flood peril that isn't covered by a traditional homeowner's insurance policy) could also end up taking a bigger hit (see table 2 for top writers of federal flood insurance). With NFIP initiating the purchase of reinsurance since last year, a portion of losses may end up in the reinsurance sector subject to flood losses breaching a certain threshold. For flood losses from Harvey, NFIP paid over $7.6 billion until Jan. 1, 2018, out of which about $1 billion was recovered from private capital, pretty much exhausting the limit. Indeed, it was good timing for NFIP to initiate procurement of reinsurance protection. For 2018, NFIP expanded its reinsurance for covering qualifying flood events through increasing the limit of its traditional reinsurance coverage to about $1.46 billion as well as $500 million coverage ceded to the capital markets using a traditional reinsurer to sponsor a catastrophe bond.

Primary Insurers Will Likely Take The Brunt Of Losses, But It's Not A Complete Wash-Out

As robust capital strength continues to define the North America property-casualty sector (see "For North American Property/Casualty Insurers, An Even Tougher Capital Stress Test Still Finds Resilience," published Jan. 8, 2018), our preliminary observation suggests potential losses will be contained by large well-capitalized national writers (see table 1) and hence, we consider Hurricane Florence an earnings event. Personal insurers with coastal exposure face the greatest risk from windstorm surge damage. However, we believe that unlike during Hurricane Harvey, state-level mandatory evacuation would lessen auto losses from flood damage. Although flood losses from homeowners insurance will likely be borne by NFIP, we expect modest spill-over losses to the high net worth writers that offer private flood coverage exceeding NFIP's limits.

In the commercial line segment, we anticipate insurers that cover properties (including private crops) and business interruption will be susceptible to large claims. Because capital is especially robust for many of our rated commercial insurers, we expect ratings to remain stable post Florence.

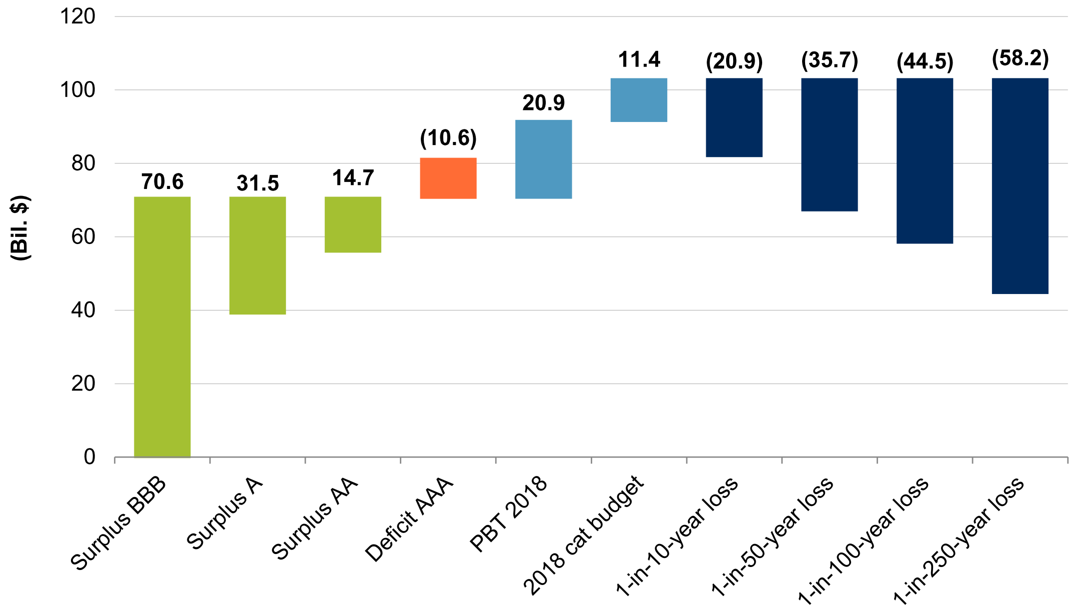
North Carolina Joint Underwriting Association (Fair Plan; NCJUA) and North Carolina Insurance Underwriting Association Coastal Property Insurance Pool (Beach Plan; CPIP) are two wind pools in North Carolina providing significant coverage for coastal areas, which are at high risk. NCJUA (statutory members' surplus of $23 million as of June 30, 2018) is a provider of last resort for homeowners and commercial property coverage except for beach areas, whereas CPIP (surplus of $1.7 billion) is a provider of property insurance covering wind and additional perils for beach and coastal areas. These wind pools are not state facilities but associations of insurance companies operating in North Carolina. Therefore, if the losses exceed surplus positions, additional assessments can be made to member primary insurers that write property insurance coverage in the state.

Florence Won't Test The Global Reinsurance Sector

We expect Florence to have minimal ratings impact on reinsurers. In view of the quantum of losses and reinsurers' exposure to the catastrophe risks in the affected states (which is not as high as exposure to other regions such as Florida), we expect the combined losses from Florence and other year-to-date nat cat events to be fully contained within the sector's annualized earnings, likely within their annualized catastrophe budget.

With reinsurers expecting a slight bump-up in earnings off the pricing increases resulting from 2017 cat losses, still-robust capitalization, and disciplined underwriting given strong ERM capabilities, the reinsurance sector is mostly resilient to nat cat losses of this magnitude. To highlight reinsurers' resilience, under a scenario of a 1-in-10-year aggregate loss experience for the top 20 global reinsurers (see note), estimated losses will be about $21 billion, which, while higher than the annual catastrophe budget of about $11.4 billion for 2018, are expected to be an earnings event (see chart). Overall, the global reinsurer capital level remains high at $605 billion including $98 billion of alternative capital as of June 30, 2018, per Aon Benfield. While the total reinsurer capital did not change from year-end 2017, an increase in alternative capital offset the decline in traditional reinsurers' capital.

Top-20 Reinsurers' Aggregate Capital Surplus Resilience To Stress At Year-End 2017



PBT--Profit before tax. Source: S&P Global Ratings' estimates.

The losses from the year-to-date nat cat events would contribute to the triggering of the aggregate limits under the reinsurance covers to the extent that those, in combination with other nat cat losses throughout the year, could reach the trigger point for these contracts. However, reinsurers have been increasingly leveraging the retrocession market through alternative capital while ceding some of the tail risks, which will help mitigate losses from other large nat cat events. Although combined sector capitalization is robust, the state of capitalization of individual reinsurers differs, and this is reflected in their ratings. This is in part due to 2017 nat cat losses, which resulted in varying degrees of hit to capital wherever the losses were not contained within 2017 earnings. In 2017, the top 20 global reinsurers lost their capital redundancy at the 'AAA' confidence level for the first time since the 2008 financial crisis. As a result, the group was deficient 5% at the 'AAA' confidence level in 2017, compared with redundancies of 2% in 2016, although it remains redundant at the 'AA' level. Some of these reinsurers are shoring up their capital position. While reinsurers' returns will barely cover their cost of capital, we believe if the industry experiences an average catastrophe year in 2018, it's reasonable to assume that this cohort could recover their 'AAA' capitalization. However, if the cumulative nat cat losses in 2018 impede reinsurers' ability to maintain capital at required levels or otherwise suffer outsize losses when compared with the sector, we could take ratings actions.

Rated Catastrophe Bonds Likely To Escape Major Harm

Catastrophe bonds that we rate, including a few of The United Services Automobile Association's (USAA) Residential Reinsurance issuances (which provide coverage to named storms in all 50 states), are exposed to Florence. However, based on the storm's expected path and even assuming an outside range of estimated industry loss of $8 billion-$20 billion, we would not expect a triggering of any of these bonds. We will not be taking any rating actions on the bonds until we observe the damage after Florence makes landfall, and most likely not until we receive loss estimates from the issuers.

We Don't Expect Any Widespread Influence On Re/Insurance Pricing

Pricing in affected regions and lines of business may rise as re/insurers look to recoup losses. However, we don't view the estimated amount of losses as disruptive enough to create a ripple effect when it comes to national pricing for primary insurance business, though it may provide some support for ongoing rate actions by primary insurers for certain business lines. The same sentiment prevails for global reinsurance pricing: the reinsurance sector got some rate increases following 2017 catastrophe losses but the pricing momentum is fading and Florence-related losses would not stall that trend.

Table 1

Top 30 Insurers In North Carolina (N.C.) And South Carolina (S.C.) (Mil. $)

					Line of Business DPW as %age of DPW in N.C. & S.C.			
Company*	Direct premiums written (DPW) - N.C. & S.C.	Market share in N.C. & S.C. by DPW (%)	DPW concentration in N.C. & S.C. (% of group U.S. DPW)	N.C. & S.C. catastrophe risk premiums as % of statutory capital and surplus	Commercial property§	Personal property**	Auto -- physical damage	Private flood & crop
State Farm	2,894	11.5	4.5	1.7	3.0	55.2	26.8	-
Nationwide Mutual Group	1,835	7.3	9.5	7.4	10.8	49.2	28.9	0.0
Berkshire Hathaway Inc.	1,490	5.9	3.9	0.4	5.7	35.7	36.0	0.0
Allstate Corp	1,402	5.6	4.4	4.5	3.4	55.0	30.7	-
USAA	1,281	5.1	6.4	3.1	7.6	56.7	29.1	-
Liberty Mutual	1,161	4.6	3.4	3.6	24.1	31.1	16.4	0.0
North Carolina Farm Bureau Insurance	1,087	4.3	100.0	59.9	8.7	56.4	25.1	0.2
Travelers Companies Inc.	1,061	4.2	4.3	2.3	18.0	26.5	12.5	-
Progressive	895	3.5	3.2	4.2	7.5	37.4	34.7	-

Table 1

Top 30 Insurers In North Carolina (N.C.) And South Carolina (S.C.) (Mil. $) (cont.)

National General Holdings Corp	676	2.7	16.1	23.1	5.2	40.7	42.7	-
Chubb	553	2.2	2.6	1.4	34.5	11.2	1.4	15.2
Auto-Owners Insurance	548	2.2	7.9	2.9	23.6	32.3	14.8	-
Erie Insurance	546	2.2	8.2	3.6	13.0	45.6	22.2	-
Zurich	475	1.9	3.6	2.3	36.0	-	3.5	12.2
American International Group	467	1.9	3.1	0.9	34.0	11.5	1.0	3.5
Hartford Financial Services	457	1.8	4.1	1.4	22.7	12.9	7.2	0.0
Cincinnati Financial Corp.	337	1.3	6.9	3.2	29.5	19.4	9.9	0.0
CNA Financial Corp.	297	1.2	2.8	1.3	48.9	-	0.4	-
W. R. Berkley Corp.	235	0.9	4.1	0.4	11.0	0.3	1.7	-
Assurant Inc.	224	0.9	3.4	11.7	51.8	28.6	0.2	1.6
Selective Insurance Group Inc.	218	0.9	8.0	5.9	41.9	4.7	7.1	-
American Financial Group Inc.	213	0.8	3.6	1.2	15.1	0.7	2.6	2.8
Tokio Marine	204	0.8	3.0	0.9	33.7	1.9	3.8	15.1
Builders Mutual Insurance Co.	187	0.7	55.7	3.2	6.1	0.1	1.5	-
Farmers Insurance Group of Cos	172	0.7	0.9	2.6	26.4	62.3	4.0	-
MetLife Inc.	168	0.7	4.6	4.8	1.4	63.0	34.0	-
AF Group	161	0.6	12.0	-	-	-	-	-
Sentry Insurance a Mutual Co.	160	0.6	7.1	1.1	9.5	27.1	30.6	-
Penn National Insurance	148	0.6	19.9	13.5	21.9	31.5	16.1	-
Arch Capital	148	0.6	4.1	0.7	13.9	-	1.0	-

Table 1

Top 30 Insurers In North Carolina (N.C.) And South Carolina (S.C.) (Mil. $) (cont.)

Top 30	19,701	78.1	4.7	2.0	13.8	37.8	21.9	1.0
P&C Industry	25,232	100.0	3.9	1.6	15.9	34.6	18.7	1.2

Source: S&P Global Market Intelligence, based on U.S. statutory filings. *Company figures based on SNL P&C Group data. §Commercial property premiums include: Aircraft, Allied Lines, Boiler & Machinery, Commercial Auto PD, Cmmercial Multi Peril (NL), Earthquake, Federal Flood, Fire, Inland Marine, Multiple Peril Crop, Ocean Marine, Private Crop, and Private Flood. **Personal Property premiums include: Farmowners Multi Peril, Homeowners Multi Peril, and Private Passenger Auto PD .

Table 2

Top 30 Insurers In North Carolina And South Carolina For Federal Flood

Rank	Company*	2017 direct premiums written (mil. $)	Market share (%)
1	Assurant Inc.	48.2	23.5
2	Selective Insurance Group Inc.	30.4	14.8
3	Hartford Financial Services	25.2	12.3
4	Wright National Flood Ins Co.	22.5	11.0
5	USAA	13.8	6.7
6	North Carolina Farm Bureau Insurance	12.3	6.0
7	Allstate Corp	9.1	4.4
8	Bankers Financial Corp.	7.8	3.8
9	Auto-Owners Insurance	5.5	2.7
10	IAT Insurance	5.4	2.6
11	Progressive	5.2	2.5
12	United Insurance Holdings	3.3	1.6
13	National General Holdings Corp	2.9	1.4
14	SC Farm Bureau Fedn	2.6	1.2
15	Universal Group Inc.	1.7	0.8
16	American Family Insurance Grp	1.6	0.8
17	QBE	1.5	0.7
18	Liberty Mutual	1.5	0.7
19	First Protective Insurance Co.	0.7	0.4
20	Farmers Insurance Group of Cos	0.6	0.3
21	Capitol Preferred Insurance Co	0.5	0.3
22	First American Financial Corp.	0.4	0.2
23	Tokio Marine	0.4	0.2
24	PURE	0.4	0.2
25	MetLife Inc.	0.3	0.2
26	American International Group	0.3	0.2
27	Westfield Insurance	0.3	0.1

Table 2

Top 30 Insurers In North Carolina And South Carolina For Federal Flood (cont.)

Rank	Company*	2017 direct premiums written (mil. $)	Market share (%)
28	Main Street America	0.2	0.1
29	Gulfstream P&C Insurance Co.	0.2	0.1
30	American Financial Group Inc.	0.1	0.1

Source: S&P Global Market Intelligence, based on U.S. statutory filings. *Company figures based on SNL P&C Group data.

Note: The top 20 global reinsurers referred to are Allied World, Arch, Aspen, AXIS, Everest Re, Hannover Re, Hiscox, Lancashire, Lloyd's, MS Amlin, Munich Re, PartnerRe, Qatar, RenRe, SCOR, Sirius, Swiss Re, TransRe, Validus, and XL.

This report does not constitute a rating action.

Related Research

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- Global Reinsurers' Returns Will Barely Cover Capital Costs In 2018 And 2019, Sept. 4, 2018
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- Capitalization Remains A Pillar Of Strength For Global Reinsurers, Aug. 15, 2018
- How Reinsurers Have Learned To Align Third-Party Capital With Their Needs, Aug. 14, 2018
- Are Global Reinsurers Ready For Another Year Of Active Natural Catastrophes?, July 25, 2018
- For North American Property/Casualty Insurers, An Even Tougher Capital Stress Test Still Finds Resilience, Jan. 8, 2018

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