SPECTRUM
Asset Management

Insurers Prepared For Hurricane Harvey

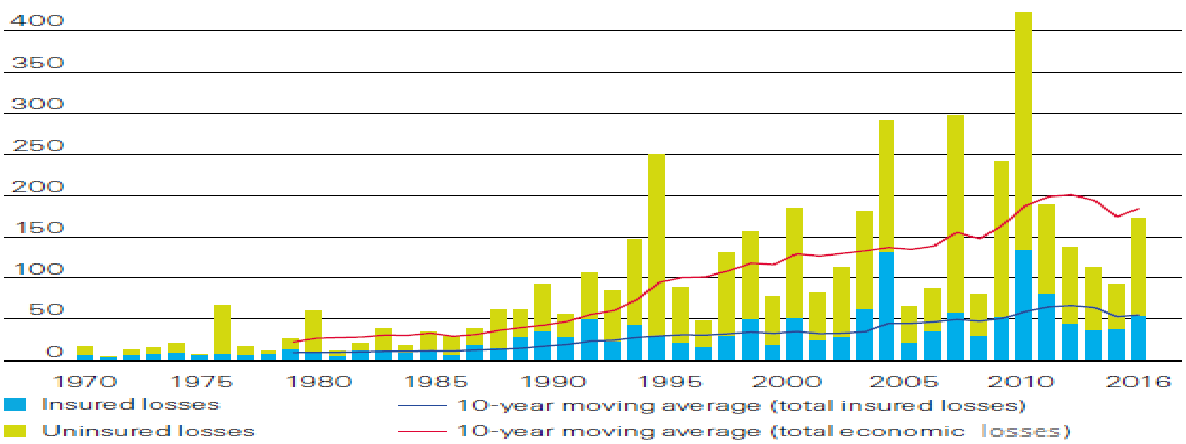
August 31, 2017

As we have previously written, the August-October Atlantic wind season has historically been the peak time for natural catastrophes (CATs), and a costly period for property and casualty (P&C) insurers. *Hurricane Harvey* was the first Category 4 storm to make landfall in the U.S. in over a decade, and the most notable hurricane to hit Texas since Ike in 2008. Harvey shut down major oil and gas operations, and deluged the Southeast part of the state, including the highly-populated Houston area, with record rainfall and flooding. CAT conditions continue, and the magnitude of damage will take time to determine. Sadly, fatalities are likely to rise. In addition, individuals will be faced with unforeseen financial burdens as many lack flood insurance for their homes. While Harvey could have a material earnings impact on P&C insurers, this hurricane is *unlikely to substantially impair the industry's strong balance sheet*.

Despite tragic social distress and economic loss, it is often the aggregation of CAT events (rather than a single storm like Harvey) that significantly harms the P&C industry. For example, "Superstorm" Sandy in 2012, one of the costliest on record, was largely an earnings rather than credit event for insurers.

While the less populated parts of Southeast Texas took a direct hit from Harvey's winds, flooding has been the major source of destruction state-wide, particularly in the Houston area. Flood damage is typically excluded from private homeowners policies. However, sizable insured claims are likely to come from auto damage as well as commercial coverages such offshore energy and business interruption. Notably, the commercial market is less concentrated among private insurers than homeowners. While the economic cost could be larger than $100 billion (similar to Katrina losses in 2005), insurance payouts are expected to be much lower.

P&C companies have improved risk management capabilities, and accumulated record levels of capital — approximately $700B in P&C surplus plus substantial reinsurance capacity — after a period of otherwise low-to-normal claims activity and persistent reserve releases. Also, Harvey is unlikely to drive a shakeout of non-traditional sources of reinsurance (*e.g.,* catastrophe bonds), which have added a layer of protection while also increasing competition. Given these factors, it is improbable that a record CAT year (like in 2005 or 2011) would significantly deplete the industry's robust capital position.



Economic losses = insured + uninsured losses
Source: Cat Perils and Swiss Re Institute.

The leading insurers in which Spectrum invests continue to maintain underwriting discipline (limiting risk concentrations) and sound balance sheets with significant excess capital, thereby providing resilience to major CATs. In our opinion, top tier insurers continue to provide diverse, tailored and unique coverages which differentiate and fortify their competitive positions.

Chad Stogel, Vice President
Joe Urciuoli, Executive Director