SPECTRUM
Asset Management

Hurricane Irma Highlights Active Storm Season

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This year is turning out to be the most active Atlantic wind season in quite a while from an economic and insured loss perspective. As Hurricane Irma ravaged the Caribbean and parts of Florida — only days after Harvey inundated Texas — we are reminded of the economic, financial and societal risks posed by natural disasters. Now a tropical storm, Irma continues to head northwest out of Florida, while another (Hurricane Jose) is not currently expected to make U.S. landfall. In addition, last week Mexico suffered substantial human losses from a large earthquake and Hurricane Katia, the effects of which are unlikely to result in material insured losses.

Despite having moved west of initial forecasts of a major hurricane strike to Miami, Irma nonetheless devastated Caribbean islands such as St. Martin, Anguilla and Cuba, and the Florida Keys and mainland Florida with strong winds and storm surge. Prior estimates of a worst-case Category 4 or 5 direct hit to Miami were modeled at 1-in-100 (1% likelihood in any given year) to 1-in-250 year (0.4%) insured losses of over $100 billion. Catastrophe (CAT) modeling firm AIR Worldwide today reported preliminary U.S. loss estimates from Irma ranging from $20 billion to over $40 billion. Still, a $40 billion insured loss could be the second largest in history only to the approximate $50B in losses from Hurricane Katrina in 2005. Hurricane Harvey may also be among the most significant insured losses in history at >$20 billion, based on initial estimates (see our prior note, "Insurers Prepared For Hurricane Harvey"). The loss estimate for Harvey is only a fraction of the total economic impact. Due to lower net exposures to Florida by national players such as Allstate and Travelers, the reinsurance industry is positioned to have more meaningful risk than the major primary insurers.

There are several months left in the Atlantic wind season. However, even had Irma stayed the original course and resulted in an unlikely 1-in-250-year event, leading reinsurers have disclosed that their loss exposures in such a modeled scenario remain below 30% of shareholders' equity. In order to maintain robust balance sheets and defend ratings post-event, reinsurers could implement credit-friendly plans such as curtailing share buyback programs, or issuing common and/or preferred. For historic context, following Hurricanes Katrina, Rita and Wilma of 2005 — when a more substantial portion of equity was exposed — most insurers recouped losses through subsequent earnings. Furthermore, while a single event is unlikely to increase pricing, a higher frequency of losses of historic magnitude or a change in the perception of risks could drive higher prices, thus strengthening future earnings prospects.

In the wake of this season's storms, insurance executives remind us that this is why the industry exists. It is also important to put loss estimates into context relative to the *record levels of capital* for U.S. P&C insurers (>$700 billion in surplus) and global reinsurance capacity (~$600 billion). Total reinsurance capacity includes a sizable amount of alternative reinsurance capital (ARC) protection (see our 2014 Bermuda field trip note) in the form of CAT bonds, for example. CAT bonds act as *bail-in* style funds in the event of pre-specified insurance losses. ARC protection, in addition to substantial coverage from the Florida Hurricane Catastrophe Fund, should mitigate overall losses for traditional reinsurers.

Spectrum does NOT have direct investments in CAT bonds or other forms of ARC

From a credit perspective, Irma appears to be more manageable for insurers than originally projected. Notably, even if the industry sustains additional natural CAT events, these perils should be supported by the industry's strong balance sheet.

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