SPECTRUM
Asset Management

Winter Storm Uri

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The extreme cold from Winter Storm Uri in mid-February affected a large portion of the US, most notably Texas. Uri led to life threatening conditions as the region was paralyzed with power outages, loss of heat and water shortages.

The Electric Reliability Council of Texas (ERCOT), which manages the flow of electricity to the vast majority of Texas, was overwhelmed by spikes in energy demand and substantial power supply coming offline due to Uri. Freeze conditions disabled conventional electric generation (*e.g.,* natural gas plants), which provide a meaningful source of electricity in Texas, while creating bottlenecks in transportation of fuel to supply those generation plants and to heat homes. This resulted in an exponential increase in electric and gas prices, creating liquidity challenges for some providers. While frozen wind turbines aggravated the situation, it is common for wind power in colder states to be equipped with technology to better deal with winter weather. The deregulated Texas power market failed to have sufficient available capacity for this extreme event. According to Moody's, these cost and reliability issues represent a material ESG (social) risk factor, which supported the agency's downgrade of ERCOT's issuer rating to A1 and revision of the outlook to negative. Also, ERCOT's CEO was terminated and several board members stepped down. Furthermore, the severity of this event led to the bankruptcy of Brazos Electric Power Cooperative, the largest generation and transmission electric cooperative in the state. There are ongoing legislative discussions to improve grid stability and to ease the energy market's liquidity issues and financial burdens on consumers. Outside of Texas, electric power in the US tends to be better integrated and operates with a larger reserve margin for shock events. **Our investments in US utilities are predominantly rate regulated and in stable jurisdictions. Spectrum does not have direct exposure to any distressed Texas utilities.**

For banks, the loss content from Uri should be modest. Banks' loan exposures are often collateralized, and even if that collateral is damaged, insurance generally covers that. Also, if a storm forces a business to close for a while – typically due to physical property damage – business interruption insurance could help to soften the blow. Furthermore, large storms tend to attract governmental financial help, which supports banks' loan quality.

For insurers, damage to infrastructure including burst pipes in homes and businesses, and legal liability will result in meaningful claims. Initial insured loss estimates range from $10 billion to $20 billion, which would make Uri the most expensive winter storm on record and compares to recent costly hurricanes like Harvey. Unlike most natural catastrophe events, Uri is unique in that freezing will likely be a lead cause of property damage. Also, losses often accumulate later in the year (*e.g.,* due to tropical storms) and as such this event could have a different effect on reinsurance cover, deductibles and other factors. Demand surge is also expected to come into play, raising the cost of replacement materials and loss adjustment expenses. While Uri will be a hit to Property & Casualty (P&C) (re)insurance earnings, the industry should remain resilient due to robust capitalization and diversification.

Our constructive view on the P&C sector is reinforced by positive discussions with several insurance company executives last week at the virtual Association of Insurance and Financial Analysts "AIFA" Conference. Notwithstanding ongoing COVID loss development, among other issues, the rising frequency and severity of extreme weather in recent years indicates a trend supporting climate change which should continue to foster strong P&C pricing power and favorable underwriting terms. This should improve profitability. **Uri is expected to be manageable for the insurers in which we invest**.

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