[Here's what 100 years' worth of hurricane data says about losses and CAT reinsurance [Report]]

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By Rosalie L. Donlon

Much of the media attention on climate change focuses on the meteorological effects, such as warmer temperatures, melting icecaps and rising oceans.

Of more importance to the insurance industry are questions that receive far less attention, for example:

- How will these trends impact catastrophe reinsurance contracts and related securities?
- Will hurricanes be more frequent, more severe or both?
- Will insurance losses be greater?

A new report from Karen Clark & Company (KCC), titled "Climate Change and Hurricane Loss: Perspectives for Investors," looks at more than 100 years of historical hurricane data to provide a basic perspective on the frequency and severity of insurance loss for investors. The report also examines the challenges of predicting hurricanes in the short term and offers perspective for long-term investors in the catastrophe market.

KCC's report provides context for investors as well as evidence that climate change has had no measurable effect on the North Atlantic hurricanes that are most often responsible for CAT market losses. According to the Intergovernmental Panel on Climate Change, as cited in KCC's report, loss levels have gone up over time primarily due to increases in the value of buildings now standing in the path of hurricanes.

The report concludes that the loss potential of the CAT market is almost the same this year as it was last year and five years ago, the same as it will be next year and five years from now after adjusting for increases in insured property values. This is positive news for investors looking for investments in the next three to five years, with the caveat that predicting hurricane profiles is an inexact science at best.

Factors for investors to consider

Atlantic hurricanes are just one subset of what investors in the insurance industry worry about, Karen Clark, president and CEO of KCC says, because it's the most important segment for the industry. "U.S. hurricane risk in the North Atlantic basin accounts for about 25% of global insured CAT losses," she explains. "Most CAT bonds and investors are heavily weighted to the Atlantic basin as well."

Investors and underwriters need to understand building codes, Clark says. They vary by state and in some cases by locality, especially along the coast, and a national building code isn't likely to be enacted any time soon. When evaluating risk, underwriters and investors should ask:

- For new construction are the buildings really being built to the most current code?
- For an existing structure, how old is the building?
- What was the code in effect when the building was constructed?
- How stringent is the enforcement of the building code?

“Age is an important variable for wind,” Clark points out. The age of the roof—especially on residential properties—is critical for determining how much wind damage a building can sustain. “That’s more important than the age of the building itself,” she adds.

Investors and underwriters also should enquire about the cladding of the building, which includes siding, glazing and glass. In flood-prone areas or designated flood zones, looking at the building’s elevation is the first step.

Increased demand

Clark sees increasing demand for CAT reinsurance and investment over the long term. “The driving factor is increasing property values,” she says, “which cause loss potential to double every 10 years.” Another key factor is that much of the loss in a catastrophe isn’t insured, for example, properties that may have flood insurance through the National Flood Insurance Program. “It’s rare to have private flood insurance,” she notes.

There remain major perils that are not insured for, such as earthquakes and flood. Clark predicts that “Investor demand will keep going up and the question is, ‘Can the private market come up with creative solutions that deal with some of these additional perils and costs?’”

For investors to capitalize on opportunities in the CAT market they will need to conduct careful research and risk assessment. “Investors really have to look at what the scientists are saying and ignore the media hype when weighing the pros and cons of their investment,” Clark says. “Much of what you hear in the general press or media isn’t supported by scientific fact.”

Editor’s note: The full report from Karen Clark & Company is available upon request from the company’s website by clicking here: http://www.karenclarkandco.com/index.html.