

Capital and finance: Can't see the wood for the trees

Hurricane Irene has been and gone and most of the trees in the NE USA are still pointing skyward, but it all could have been very different. If nothing else, Irene is a powerful reminder that hurricanes do hit the NE and what could happen if a big un gets into the wrong places.

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Driving through Connecticut

BRAVE partner, Chris Cloke-Browne, was driving through Connecticut with a reinsurance broker one fine day. Barring what the broker said, but of course if a hurricane does hit up here the losses will be far larger than the models predict. Still not getting it, Chris was invited to look around him. "Trees!", the broker said at last. "The catastrophe models are based on Florida where there aren't any trees. If something hits up here there will be a tree through every house".

Watching the weather channel

So, as Irene approached North Carolina, Chris was watching the weather channel a little more intently than usual. A friend of his in North Carolina had already had two trees down in his street over the previous 18 months doing everything from minor damage to a roof, to having the house declared as unsafe by the Fire Department. Both of these events occurred without the help of hurricane force winds.

A big un

Irene approached as a reasonably strong category 2 hurricane. Of more concern was her size. With a diameter of 500 miles Irene was a big storm. Size matters as well as strength. A normal sized storm will buffet an area for a couple of hours. As hurricanes get up to a 500 mile diameter they sustain hurricane force winds over an area for several hours. Moreover, as Ike demonstrated, once these storms can maintain their power well inland. The trees of North Carolina were waiting and they were full of foliage, making them heavier and more wind exposed than in a winter storm.

Irene was set to be the first major hurricane to hit the North East of the United States since Long Island was hit in 1938. Neither Bob in 1991, nor Gloria in 1985 were particularly powerful. Insurance markets speak of NE USA wind risk, but this was to be the real test.

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Insurance Day
August 29, 2011

Fortune favours the prepared mind

It is tough to say whose mind was prepared, but fortune favoured North Carolina. From having North Carolina firmly in the cross hairs, Irene turned and ended up just glancing the shoreline. The coast got a bit blown about, but in general the trees remained pointing skywards and the damage was not excessive.

Irene then weakened heading north and the mandatory evacuation called in all five boroughs of New York proved to be unnecessary; not that it was unwise on Mayor Bloomberg to impose it. As a last hurrah, Irene dumped all the water that she had accumulated over the Connecticut and Vermont shoreline causing major flooding.

Crop rotation in the 14th century

Leaving answers on crop rotation in the 14th century to The Young Ones, but on a similarly specialised topic: flood insurance in the USA. Flood insurance in the USA is mainly borne by the Federal Government.

Come on Irene

Strictly speaking the Dexy's Midnight Runner's song is “Come on Eileen”. There also appears to be few connections between the two names with Irene being of Greek origin and Eileen on Celtic origin. However, BRAVE Partners are far from the only people to make the connection between the Dexy's Midnight Runner's song and the storm.

That said, Irene did not really come on. The storm glanced the coast a few times and weakened. By the time it hit New York City, it was down to a tropical storm and headed inland from there where hurricanes lose power without the warm water to feed them.

Treefall

Despite Irene's route and intensity being favourable to insurers (the current top end loss estimate is \$3bn), on August 29 Insurance Day reported that “Treefall is major driver of Irene losses”. In particular, Insurance Day reports:

“Matt Nielsen, senior product manager for Risk Management Solutions US hurricane model, told Insurance Day most of the damage in New Jersey and further north was caused by treefall, which has downed powerlines and caused damage to properties.”

This is without a major sustained hurricane hit that penetrated inland. Irene didn't knock down any trees in the street of our friends in North Carolina. A large hurricane moving inland would have.

Diversification

Many investors in cat bonds and insurance linked securities look to the US North East as a diversification to Florida risk. Whilst it might well be a diversification, there is a major risk in buying these bonds based on the model results. Losses for a major storm are likely to be far greater than the models predict and there has been no recent data point to calibrate this.

BRAVE Partners urges caution for inexperienced ILS investors before entering this space. The estimated losses from the industry standard models could be badly off.

Disaster is opportunity

Many within the insurance business would not look at homeowners' insurance on Long Island and in Florida as similar. However, both markets have similar features. The major insurers are withdrawing as their catastrophe exposure because too great. This leaves a pool of uninsured homeowners who are increasingly desperate for cover. Therein lies a business opportunity.

BRAVE Partners services

BRAVE Partners LLP is a boutique investment bank that focuses on the insurance and reinsurance sector. The firm is advising on a range of projects and transactions related to catastrophe exposed homeowners' insurance. Moreover, the partners have extensive experience in the sector having funded a start-up company in Florida and structured a number of transactions around the Florida Hurricane Catastrophe Fund (FHCF).

Interaction

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- BRAVE Partners is a boutique investment bank with specific expertise in the insurance and reinsurance sector.
- Homeowners insurance in catastrophe exposed areas is a speciality for the firm.

• BRAVE Partners can:

- Advise on the value of catastrophe bonds and the accuracy of the underlying risk modelling.
- Advise management teams on developing investable business plans for catastrophe exposed homeowners insurance businesses.

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