

#### Box 17 The impact of Florida's hurricanes on the euro area insurance sector

The 2004 storm season in the eastern US was the most severe since 1886, when four hurricanes struck Texas. The four hurricanes that hit Florida in August and September 2004 caused serious damage to property and, even though a significant portion of the financial cost was borne by the state and by households, led to significant losses for the insurance sector.<sup>1</sup> For multiple events such as successive hurricanes, precise estimates of losses are difficult to compute because they involve mapping specific damage to each storm. Preliminary estimates of the losses from the 2004 hurricane season range between USD 21.2 and USD 26.2 billion, thereby making it the most costly year to date for hurricane-related claims, eclipsing the previous record of USD 22 billion in 1992. This Box assesses the likely impact for the euro area insurance sector.

The losses from hurricane damage that will be incurred by the euro area insurance sector, albeit significant for some important individual companies, are likely to be contained, with any dent in profits unlikely to entail any rating revisions. There are three reasons for this. First, losses

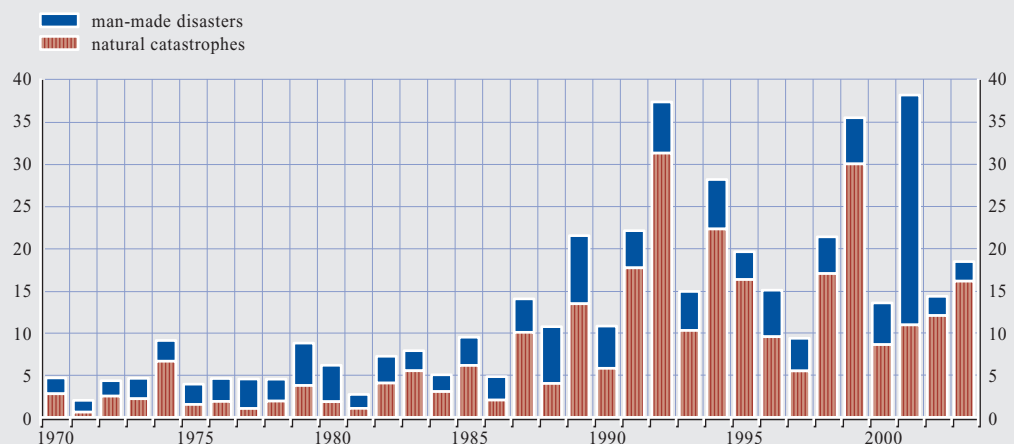
<sup>1</sup> The losses related to floods are covered by a public entity, the National Flood Insurance Program, which reduces the insured losses for insurance companies.

must be shared between primary insurers (of homes and commercial property) and reinsurance companies. Primary insurers are mostly located in the US or based in Bermuda, whereas five of the ten largest reinsurers are located in Europe and three in the euro area. Therefore, Florida's events will affect the euro area insurance sector mainly through reinsurance companies. Second, the losses incurred by the reinsurance sector will be limited as the number of successive events is high. This is because of the sharing arrangements that usually exist between primary and reinsurance companies. In a property catastrophe reinsurance contract, the primary insurer usually bears the losses up to a predetermined amount – the attachment point – with all the losses beyond this threshold being incurred by reinsurance companies. A large hurricane with the same aggregated loss as the four separate events would have been far costlier for the reinsurance sector than the costs borne for the four separate events. Indeed for four separate events, primary insurers must pay four times the amount below the attachment point, compared to only one time for a single large event. Third, primary insurers are typically covered against a single event or two events, and after the occurrence of one event, primary insurers have to pay a preset reinstatement premium to continue coverage for subsequent catastrophes. However, in the case of multiple events (more than two), the primary insurance companies will either renegotiate the contract with a new price and terms, or remain uninsured. In the middle of a hurricane season, the latter alternative can probably be ruled out. Therefore, the storm-related losses for reinsurers should be partially compensated by an increase in premium written due to a rise in protection covering multiple events.

The euro area reinsurance sector could be liable for roughly 10% of the total estimated insured losses related to the four hurricanes, with the losses being concentrated among a small number of companies and representing between 2.5% to 11% of their net premium written. Reduced profits of reinsurance companies are however likely to ease the downward pressure on premium prices that was observed in some business lines in 2004. Up to a point, this could even be beneficial for the sector.

**Chart B17.1 Real insured losses from disasters and catastrophes**

(USD billions)



Source: Swiss Re.