S&P Global
Ratings

Research

HCC Insurance Holdings Inc.

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HCC Insurance Holdings Inc.

Rationale

Business Risk Profile: Very Strong
• Very strong competitive position due to diversified specialty property/casualty (P/C) and accident and health business • Strong brand recognition in medical stop-loss, aviation, surety, marine and energy, and professional liability • Outperformer among peer group with a track record of robust underwriting results

Financial Risk Profile: Very Strong
• Commitment to maintain capital adequacy at the 'AA' level, based on S&P Global Ratings' capital model, supported by a consistent track record of superior underwriting results • Intermediate risk position based on conservative investment portfolio and short–tailed, well-diversified, and uncorrelated specialty product lines

Other Factors
• Enterprise risk management (ERM) and management and governance are strong and support the rating • One-notch holistic adjustment to 'aa-' anchor due to TMHCC's long-standing sustainable track record of superior operating performance with very low volatility • Highly strategically important to Tokio Marine Group under our group rating methodology criteria • One notch of uplift from the 'A+' rating assigned to the core and guaranteed subsidiaries of TMNF reflects our insulation criteria

Factors Specific to the Holding Company
Our ratings on the U.S.-based holding company HCC Insurance Holdings Inc. (HCC) reflect structural subordination to the obligations of its insurance operating subsidiaries and its reliance on dividends from its regulated insurance operating units to meet its obligations.

Outlook: Stable

The stable outlook on HCC and its core and guaranteed operating subsidiaries (collectively TMHCC) is consistent with that on the core and guaranteed operating subsidiaries of Tokio Marine & Nichido Fire Insurance Co. Ltd. (TMNF). The outlook reflects our expectation that TMHCC will maintain very strong capital and earnings primarily through superior underwriting discipline with no material change in its overall risk profile. We also expect TMHCC to operate independently from the group, which would enable us to continue to view TMHCC as an insulated subsidiary of TMNF.

Downside scenario

We may consider lowering the ratings in the next 24 months if TMHCC's stand-alone credit characteristics deteriorate, we lower the ratings on the core and guaranteed operating subsidiaries of TMNF, we no longer view TMHCC as an insulated subsidiary due to increased dependence on the group, or capital adequacy weakens to below the 'AA' level for a sustained period.

Upside scenario

Although unlikely in the next 24 months, we may raise the ratings on TMHCC if we raise the ratings on the core and guaranteed operating subsidiaries of TMNF.

Base-Case Scenario

Macroeconomic Assumptions

- U.S. real GDP growth of 2.2% in 2017 and 2.3% in 2018
- Average 10-year Treasury rate of 2.4% in 2017 and 2.7% in 2018
- U.S. core consumer price index of 1.8% in 2017 and 2.1% in 2018

Company-Specific Assumptions

- Premium growth in the low-to-mid single digits over the next few years
- Generally accepted accounting principles (GAAP) combined ratio of less than 90% for 2017-2018
- Consolidated capital adequacy at the 'AA' rating level during 2017-2018
- Financial leverage less than 20% and fixed-charge coverage exceeding 8x during 2017-2018

Key Metrics

	--Year ended Dec. 31--				
(Mil. $)	**2018***	**2017***	**2016**	**2015**	**2014**
Gross premiums written	3,790	3,716	3,643	3,578	3,002
P/C net combined ratio (%)	< 90	< 90	87.6	86.1	82.5
Financial leverage (%)	< 20	< 20	18.4	19.1	17.5
Fixed-charge coverage (x)	> 8	> 8	44.9	12.5	20.5

*Forecast data reflect S&P Global's base-case assumptions.

Company Description

TMHCC is a U.S.-based multiline specialty insurer that underwrites a variety of noncorrelated specialty insurance products, including P/C, accident and health, surety, credit, aviation, and agriculture. Through HCC Life Insurance Co. (HCC Life), the core of its accident and health segment, the company offers medical stop-loss insurance, which is one of TMHCC's largest lines. Overall, TMHCC offers more than 100 specialty insurance products and conducts business in approximately 180 countries through offices in the U.S., the U.K., Ireland, and Spain. Following the October 2015 close of its $7.5 billion acquisition, HCC became a wholly owned subsidiary of TMNF. Shortly thereafter, the HCC subgroup was rebranded Tokio Marine HCC.

Business Risk Profile: Very Strong

Our view of TMHCC's business risk profile reflects the company's very strong competitive position, based on a track record of outperforming peers and the industry, and its well-established and diversified market position and brand name in a wide range of specialty product lines.

Insurance industry and country risk

We view TMHCC's insurance industry and country risk as intermediate, reflecting very low country risk, intermediate industry risk facing its P/C insurance operations, and low industry risk facing its accident and health insurance operations. The group primarily operates in the U.S., and its very low country risk reflects high income prospects as well as the stable political environment, financial system, payment culture, and rule of law. We believe TMHCC's P/C insurance operations are exposed to intermediate industry risks because we have a cautious view of the industry's inherent product risk. Such risk stems from uncertainty in claims amounts, payment patterns from catastrophe losses, and reserve volatility in certain long-tail lines. We believe its accident and health insurance operations are exposed to low industry risks as a result of neutral product risk and high operational barriers to entry. Overall, we believe domestic multiline primary insurers will continue to benefit from geographic and product diversification, moderate operational barriers, and stable growth prospects in U.S. markets, which an effective institutional framework supports.

Table 1

Industry And Country Risk		
Insurance sector	**IICRA**	**Business mix (%)**
U.S. P/C	Intermediate risk	55.21
U.S. health	Low risk	31.48
U.K. P/C	Intermediate risk	9.26
Germany P/C	Low risk	0.78
Australia P/C	Low risk	0.78
Spain P/C	Intermediate risk	0.73
Canada P/C	Low risk	0.65
Ireland P/C	Intermediate risk	0.61
Switzerland P/C	Very low risk	0.51

Competitive position

We regard TMHCC's competitive position as very strong due to its well-diversified P/C and accident and health segments. Each segment represents at least 20% of the company's overall gross premiums written. In addition, TMHCC benefits from strong brand recognition in its various specialty markets, such as medical stop-loss, aviation, surety, professional liability, marine and energy, and agriculture. Because TMHCC's product lines are diversified and the company maintains a strong reputation among producers, it can quickly deemphasize lines in which the pricing is highly competitive and instead focus on areas where rates remain strong.

The company historically has grown its product lines through small acquisitions of underwriting teams and agencies that specialize in targeted products. The most recent notable acquisitions include Producers Ag Insurance Group Inc. and International Agriculture Insurance Solutions LLC, crop insurers and agents; On Call International LLC, a provider of travel risk-management services; and Bail USA Inc., an exclusive writer of federal and state bail bonds. TMHCC's strategy with some newer product lines is to utilize significant quota-share reinsurance coverage and retain more of the risk as the lines season, which helps it maintain low volatility of earnings.

Table 2

HCC Insurance Holdings Inc. Competitive Position					
	--Year ended Dec. 31--				
(Mil. $)	**2016**	**2015**	**2014**	**2013**	**2012**
Gross premiums written	3,643	3,578	3,002	2,880	2,784
Change in gross premiums written (%)	1.8	19.2	4.2	3.5	5.1
Net premiums written	2,987	2,826	2,373	2,255	2,253
Change in net premiums earned (%)	6.2	19.4	3.8	(0.2)	5.4
Reinsurance utilization (%)	18.0	21.0	20.9	21.7	19.1

TMHCC has a track record of superior underwriting results that have consistently outperformed its peers'. From 2012-2016, TMHCC had a five-year average GAAP combined ratio of 84.9%, which was far better than the average of the P/C industry and its peers during the same period. TMHCC's underwriting compensation practices are based on profitability, which helps the company maintain the quality of business despite its decentralized underwriting approach. Each of TMHCC's business units makes independent risk-selection and pricing decisions.

We believe TMHCC's strong underwriting expertise and pricing discipline will help sustain its very strong competitive position. The acquisition by TMNF should provide additional growth opportunities for TMHCC. We expect TMHCC to underwrite any future opportunities with the same expertise and diligence as it currently exercises. In our base-case scenario, we expect TMHCC's premiums to grow in the low-to-mid single digits over the next few years, reflecting modest growth in both its accident and health and P/C segments.

We expect the accident and health segment, primarily HCC Life, to remain a highly important source of revenue and earnings for the overall TMHCC enterprise. HCC Life is one of the largest writers of medical stop-loss insurance in a relatively fragmented market. In this market, we believe HCC Life's key competitive advantages are its long-standing, specialized expertise with the product, good knowledge of the marketplace, highly stable and experienced management team, and like the rest of the enterprise, its disciplined underwriting approach. TMHCC has been successful in the accident and health segment with consistent positive revenue growth year-to-year. This segment's core medical stop-loss business is unaffected by key provisions of health care reform, including medical loss ratio minimums and industry taxes. We therefore expect health care reform to have a limited impact on TMHCC's accident and health segment.

Financial Risk Profile: Very Strong

Capital and earnings

TMHCC's consolidated operating company capital adequacy (combined P/C and life) is extremely strong and redundant at the 'AAA' rating level based on our year-end 2016 capital adequacy model. We expect TMHCC to sustain at least very strong capital adequacy as management has committed to maintaining capital adequacy at a minimum 10% above the 'AA' level, as per our risk-based capital model.

Table 3

HCC Insurance Holdings Inc. Capitalization Statistics					
	--Year ended Dec. 31--				
(Mil. $)	**2016**	**2015**	**2014**	**2013**	**2012**
Total assets	11,262	10,826	10,714	10,345	10,268
Common shareholders' equity	4,269	3,904	3,903	3,674	3,543
Change in common shareholders' equity (%)	9.4	0.0	6.2	3.7	8.2
Reinsurance utilization (%)	18.0	21.0	20.9	21.7	19.1
Reinsurance recoverables to shareholders' equity (%)	27.6	30.6	31.2	34.8	30.2

Table 4

HCC Insurance Holdings Inc. Earnings Statistics					
	--Year ended Dec. 31--				
(Mil. $)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenue	3,276	3,025	2,586	2,495	2,496
Net income (attributable to all shareholders)	424	302	458	407	391
Return on revenue (%)	17.4	14.5	24.2	22.5	22.2
Return on revenue (incl. realized capital gains/losses) (%)	17.8	14.9	26.1	23.8	23.1

Table 4

HCC Insurance Holdings Inc. Earnings Statistics (cont.)					
	--Year ended Dec. 31--				
(Mil. $)	**2016**	**2015**	**2014**	**2013**	**2012**
Return on shareholders' equity (reported) (%)	10.4	7.7	12.1	11.3	11.5
Net expense ratio (%)	24.1	24.2	25.4	25.0	24.4
Net loss ratio (%)	63.5	61.9	57.1	59.1	59.7
Net combined ratio (%)	87.6	86.1	82.5	84.1	84.1
Net (favorable)/unfavorable prior year loss ratio (%)	(0.8)	(2.0)	(4.2)	(5.5)	(5.1)

TMHCC has a track record of very strong operating performance, supported primarily by superior underwriting results. TMHCC has not only consistently outperformed its highly rated peers, but also sustained its underwriting performance regardless of continued soft market cycles, catastrophes, and a sluggish economic recovery. Despite the change of ownership, we believe TMHCC will maintain its operational independence and continue to deliver sustainable financial performance. In our base-case scenario, we expect TMHCC's GAAP combined ratio to be less than 90% in 2017-2018 with limited losses from catastrophe events. The quality of earnings will remain very good as a result of the group's well-diversified specialty product lines and geographic diversification. TMHCC's stable net investment income from its conservative investment portfolio has enhanced its overall earnings profile. The company had an average return on revenue of 20.2% during 2012-2016.

Risk position

TMHCC's risk position is intermediate based on its diversified business profile in various specialty product lines, which are generally correlated to a lesser degree and not commoditized. In TMHCC's North America P/C segment, the liability lines primarily include directors and officers (D&O) exposures. In our view, this segment may be susceptible to high severity from time to time because of potential litigation from D&O exposures. However, TMHCC uses significant reinsurance to mitigate these exposures and it maintains generally conservative loss reserves to support them. Although the company has entered a couple of newer lines, we don't expect any material change in its overall risk profile that could compromise its long-term underwriting profitability.

Table 5

HCC Insurance Holdings Inc. Risk Position					
	--Year ended Dec. 31--				
(Mil. $)	**2016**	**2015**	**2014**	**2013**	**2012**
Total invested assets	7,395	7,045	7,386	6,903	7,123
Change in invested assets (%)	5.0	(4.6)	7.0	(3.1)	11.6
Net investment income	212	210	222	220	223
Realized capital gains/(losses)	16	15	66	42	30
Net investment yield (%)	2.9	2.9	3.1	3.1	3.3
Net investment yield including realized capital gains/(losses) (%)	3.1	3.1	4.0	3.7	3.7
Portfolio composition (%)					
Cash and short-term investments	8.9	8.3	4.9	3.4	6.1
Bonds	81.5	88.2	89.5	87.2	88.2
Equity investments	2.5	1.6	4.0	7.5	4.0

Table 5

HCC Insurance Holdings Inc. Risk Position (cont.)					
	--Year ended Dec. 31--				
(Mil. $)	2016	2015	2014	2013	2012
Loans	5.3	0.0	0.0	0.0	0.0
Other investments	1.9	1.9	1.6	1.8	1.7

TMHCC does not take large investment risks. As of Dec. 31, 2016, its investment portfolio was relatively well diversified by sector with only a moderate obligor concentration. The portfolio is composed of 81.5% fixed-maturity securities, 8.9% cash and short-term investments, 5.3% loans, 2.5% equities, and the remaining in other investments. The fixed-maturity portfolio has an average credit rating of 'AA-' but we expect that to move to 'A+' as the company shifts its mix.

Financial flexibility

TMHCC has strong financial flexibility in our view, which reflects its proven historical record of access to capital markets and its ability to obtain reinsurance from highly rated reinsurers. We expect financial flexibility to remain strong in spite of its new ownership structure. As of Dec. 31, 2016, TMHCC's consolidated financial leverage remained relatively modest at about 18.4%, supported by strong fixed-charge coverage of about 44.9x. TMHCC's fixed-charge coverage has significantly improved since 2015 as the company redeemed its $300 million 6.30% senior notes due November 2019 and paid off its $825 million revolving loan facility, replacing them with a $475 million term loan and $700 million revolving loan facility, respectively, from the Bank of Tokyo-Mitsubishi. We expect TMHCC's consolidated financial leverage to be below 20% and its fixed-charge coverage to exceed 8x over the next few years.

Table 6

HCC Insurance Holdings Inc. Financial Flexibility					
	--Year ended Dec. 31--				
(Mil. $)	2016	2015	2014	2013	2012
EBITDA fixed-charge coverage (x)	44.9	12.5	20.5	19.4	19.4
EBITDA fixed-charge coverage including realized and unrealized gains/(losses) (x)	46.1	12.9	22.5	20.7	20.3
Financial leverage including pension deficit as debt (%)	18.4	19.1	17.5	15.1	14.5
Cash flows					
Net cash flow from operating activities	428	186	479	263	661
Net cash flow from investing activities	(390)	44	(311)	(235)	(619)
Net cash flow from financing activities	33	(209)	(124)	(41)	(75)

Other Assessments

Enterprise risk management

As a highly strategically important subsidiary, our view of TMHCC's ERM program mirrors that of TMNF's. We assess TMNF's (and thus TMHCC's) ERM as strong, based on our positive view of the group's risk-management culture, overall risk controls, risk models, and strategic risk management. We see ERM as highly important for our ratings on the entities we rate, given the scale of the group's operations, its exposure to natural catastrophe risks, the significant proportion of domestic equities in its investment portfolio, and the operational risks it faces in its international expansion.

TMNF's strong risk-management culture is driven by established governance practices, well-articulated risk appetite statements, and a balanced compensation structure. Compared with its Japanese peers, there is low volatility in its underwriting track record, which supports our positive view of its risk controls. Although the investment portfolio's exposure to equities is high and the overall portfolio remains sensitive to changes in Japan's economy, we believe volatility risk from the equity market is partially offset by the otherwise conservative nature of the investment portfolio in terms of credit and interest rate risks. We view the group's risk models as positive, reflecting its extensive risk models and the continued use and validation of the economic capital model and catastrophe model. We believe these capabilities will enable the group to continue optimizing capital allocation and earnings, and enhance its risk-return profile.

Management and governance

We view TMHCC's management and governance practices as strong. Despite new ownership, we expect TMHCC to maintain its operational independence and continue to deliver sound financial performance. TMHCC's underwriting strategy remains decentralized. With corporate oversight, each business unit enjoys fairly independent decision making and is considered an individual profit center. TMHCC maintains underwriting discipline by rewarding underwriters based on underwriting profitability. In addition, TMHCC maintains control through acquisition of underwriting intermediaries and effectively using reinsurance coverage to mitigate risk on less-seasoned lines of business. These strategies help maintain strong earnings with low volatility.

TMHCC's management team has broad experience. Management benefits from a flat structure, which keeps cost down and provides for quicker decision-making capabilities.

Liquidity

We view TMHCC's liquidity as exceptional based on a liquid investment portfolio and access to its term loan and credit facility, which expire in December 2020.

Support

Group support

HCC is wholly owned by TMNF as of October 2015. We consider TMHCC highly strategically important to the Tokio Marine Group. However, we view TMHCC as an insulated subsidiary within the group. We therefore assess the ratings on TMHCC based on its stand-alone credit profile and up to one notch higher than TMNF's group credit profile.

Accounting Considerations

HCC ceased to be listed as a publicly traded entity upon close of the 2015 merger transaction. However, it continues to prepare nonpublic consolidated financial statements quarterly on a U.S. GAAP basis for its parent company. HCC's U.S.-domiciled insurance subsidiaries file financial statements with state insurance regulators prepared in accordance with statutory accounting principles.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of November 8, 2017)	
Operating Companies Covered By This Report	
HCC Insurance Holdings Inc.	
Counterparty Credit Rating	
Local Currency	A-/Stable/--
American Contractors Indemnity Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Avemco Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
HCC International Insurance Co. PLC	
Financial Strength Rating	
Local Currency	AA-/Stable/--
HCC Life Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
HCC Reinsurance Co. Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
HCC Specialty Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Houston Casualty Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--

Ratings Detail (As Of November 8, 2017) (cont.)	
United States Surety Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
U.S. Specialty Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Domicile	Texas

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.