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Ratings

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Markel Corp. And Operating Companies

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Markel Corp. And Operating Companies

Major Rating Factors

None

Strengths

- Strong competitive position reflects primarily the company's strong presence in U.S. specialty, and excess and surplus lines market, supported by a diversified re/insurance platform
- Very strong capital adequacy, supported by robust earnings that are in line with those of peers and by prudent reserving
- Exceptional liquidity supported by its significant liquid investment holdings

Weaknesses

- Potential volatility in operating earnings and capital owing to property catastrophe exposure, long-tail casualty reserves, and relatively high allocation to high-risk assets
- Acquisitive nature can potentially pressure capitalization
- Execution risk from pursuit of growth strategy related to non-risk-bearing operations

Rationale

The ratings on Markel Corp. (NYSE:MKL; Markel) reflect its strong business risk profile and strong financial risk profile. The company's credit profile benefits from its large and diversified re/insurance operations supporting its strong competitive position, growing contribution from non-insurance operations, and very strong capitalization. These strengths are partially offset by a moderate risk position reflecting inherent earnings volatility emanating from the company's exposure to property catastrophe, long-tail casualty business, and high-risk assets. Further supporting Markel's credit profile are strong risk controls. The strong business risk profile and strong financial risk profile lead to an 'a' or 'a-' anchor. The choice of an 'a' anchor reflects relative strength of Markel's competitive position, especially in the U.S. excess and surplus lines market.

Outlook

The outlook is stable. We expect Markel to continue reporting strong operating performance while further enhancing its operating platform with a focus on risk diversification, which will sustain its strong competitive position, and maintain very strong capitalization despite the potential for ongoing acquisitions.

Upside scenario

We could raise our ratings during the next two years if Markel's:

- Capitalization strengthens to a sustainable 'AAA' confidence level;
- Competitive position strengthens to the level of its higher-rated peers' as demonstrated by strong operating results that are supported by robust earnings from both insurance and reinsurance platforms;
- Fee-based and noninsurance operations season with the tangible earnings profile; and
- The company maintains supportive financial leverage and strong coverage metrics.

Downside scenario

Contrary to our expectations, we could lower our ratings during the next two years if Markel's risk-adjusted capitalization declines below the 'AA' confidence level, the group experiences sustained deterioration in its competitive position as shown by earnings performance consistently below peers', or if underwriting losses are meaningfully outside the company's risk tolerances. Heightened execution risks and a significant increase in financial leverage in pursuit of an aggressive growth strategy or acquisition could pressure the ratings as well.

Base-Case Scenario

Macroeconomic Assumptions

- U.S. real GDP growth of 3.0% in 2018, 2.5% in 2019, and 1.8% in 2020
- Long-term interest rate moving up: U.S. 10-year treasury interest rates of 3.0% in 2018, 3.3% in 2019, and 3.5% in 2020
- U.S. core consumer price index (CPI) of 2.2% in 2018, 2.2% in 2019, and 2.2% in 2020
- Stable industry economic outlook for property and casualty (P/C) insurers; challenging operating environment for the global P/C reinsurance sector despite some price strengthening post 2017 catastrophe events

Key Metrics

	--Year ended Dec. 31--							
(Mil. $)	**2020F**	**2019F**	**2018F**	**2017**	**2016**	**2015**	**2014**	**2013**
P/C gross premiums written (GPW)	**	**	**	5,507	4,797	4,633	4,806	3,920
Change in GPW (%)	Mid single digits	Mid single digits	Mid-to-high 30	14.8	3.5	(3.6)	22.6	56.0
P/C net combined ratio (%)	93-96	93-96	94-96	105.8	92.8	89.8	96.2	95.6
Net impact of natural catastrophe losses on the P/C combined ratio (percentage points)	5	5	5	13.3	1.8	0.0	0.0	0.8
Net income before minority interest*	600-675	575-650	400-475	401	460	589	324	284
Consolidated return on equity (%)	5-8	5-7	4-6	4.5	5.6	7.6	4.5	5.4
Consolidated return on revenue (%)	11-15	11-15	11-15	4.0	12.8	14.6	10.4	10.0
S&P Global Ratings' risk-adjusted capital adequacy | redundant/(deficient) at the 'AA' confidence level§ (%)	0-5	0-5	0-5	5-10	**	**	**	**
Financial leverage including operating leases and pension deficits (%)	21-25	24-27	25-28	26.9	24.0	23.6	24.2	25.6
EBITDA fixed-charge coverage (x)	At least 4	At least 4	At least 4	2.6	5.8	6.7	4.7	4.1

F--Forecast. Forecast data reflect S&P Global Ratings' base-case scenario. *Forecasts do not include (un)realized gains/losses; 2018 includes impact from change in tax treatment of U.K. subsidiaries. §Includes potential share repurchases & capital deployment initiatives. **Not disclosed.

Business Risk Profile: Strong

Markel's strong business risk profile is built on its strong competitive position and our assessment of intermediate risk for insurance industry and country risk for its re/insurance operations.

Markel and its insurance subsidiaries maintain a strong competitive position, reflected by a diverse product offering in various P/C lines, including U.S. primary insurance (55% of gross premiums written (GPW) as of year-end 2017), international insurance (24%), and reinsurance (21%). Markel is geographically diversified with operations in the U.S., Canada, Bermuda, the U.K., Europe, Latin America, and Asia.

Markel is recognized as one of the top players in the U.S. specialty, and excess and surplus lines market, where it has created a strong position for itself. Markel offers more than 100 different specialty and niche insurance products that are either customized for customers' unique risk profiles or targeted for markets that are underserved--a proposition that supports its competitive position in those markets. A diverse product suite allows the company to manage to the pricing environment, entering or leaving various markets when it sees opportunities or challenges.

Markel's larger platform following the Alterra acquisition has enhanced its ability to compete in the international specialty insurance and reinsurance markets. The larger platform has enabled the group to tap into reinsurance and large accounts and further develop its relationship with leading P/C brokers. However, the competitive standing in those segments is not at the same level as the U.S. business, especially reinsurance, which is more volatile as highlighted by 2017's results.

In addition, the group continues to expand its presence in the U.S. insurance market by targeting certain segments, introducing new products, and acquiring bolt-on operations (for example, SureTec Financial Corp., a surety lines writer acquired in April 2017, and State National, a provider of fronting services and lender placed auto insurance).

In pursuit of its diversification strategy over the years, Markel has been building a portfolio of fee-based and non-insurance investments: For example, CATCO (a Bermuda-based insurance-linked securities investment fund manager and reinsurance manager) and Markel Ventures (with interests in manufacturing, industrial, consulting, health care, and farming). For full-year 2017, Markel Ventures generated revenue of $1.3 billion and operating income of $119 million--a material contribution to Markel's top and bottom lines. Furthermore, the fronting business of State National acquired last year will add to the earnings as well. We expect Markel to continue to invest in and expand Markel Ventures as appropriate opportunities present themselves.

Markel's (re)insurance operating performance was in line with that of its specialty peers, as shown by its five-year (2013-2017) average combined ratio of approximately 96% and average return on revenue of approximately 10%, despite large catastrophe losses in 2017. The operating earnings benefit from substantial investment income and other fee-based/non-insurance earnings, which we expect will grow in the near term. We expect Markel's prospective operating performance to be in line with or slightly better than its peers'.

In our base-case scenario, we expect Markel's GPW to grow in the mid-to-high 30s in 2018, reflecting a full year of State National's premiums (high-single digits excluding its fronting business), mid-to-high single digits growth in insurance, and marginally negative growth in the reinsurance business. We expect competitive pressures to sustain despite some price increases post 2017 catastrophe losses. Furthermore, we expect GPW to increase around mid-single digits for 2019-2020 and the top-line from non-risk operations to grow as well.

Financial Risk Profile: Strong

We regard Markel's financial risk profile as strong overall, reflecting its very strong capital and earnings, moderate risk position, and strong financial flexibility.

Capitalization as of year-end 2017 was very strong and redundant at the 'AA' confidence level according to our proprietary risk-based generally accepted accounting principles (GAAP) capital adequacy model, and we expect it will continue to be supported by strong earnings. The capitalization assessment can be extremely strong and redundant at the 'AAA' confidence level in certain years, as was the case in 2016; however, our prospective view of capitalization is constrained by the potential for additional acquisitions as Markel builds out its insurance and noninsurance operations.

Markel's capital adequacy strength is partially offset by its moderate risk position in view of the inherent volatility in exposure to natural and manmade catastrophes, long-tail casualty lines of business, and relatively higher allocation to high-risk assets.

The investment portfolio is managed to balance the insurance and financial risk. Higher levels of equities and other high-risk assets are balanced by a large amount of cash and short-term securities and high credit quality fixed-income instruments. As of year-end 2017, Markel had total invested assets of $20.6 billion, which comprised 48% fixed-income securities, 29% equity securities, and 23% cash and short-term investments. The group has had a significant net unrealized gain position due to its buy-and-hold investment philosophy, which has benefitted from a broad increase in market valuations as well.

We believe Markel's reserves are well positioned to sustain expected losses given management's conservative reserving philosophy. Historically, Markel's operating results have benefited from significant reserve releases, which contributed on average 13 percentage points to the combined ratio over the past five-year period (2013-2017). Prospectively, we expect the reserves to continue to develop favorably but at a slower pace, reflecting the soft pricing environment.

Under our base case, we expect a combined ratio of 93%-96% for 2018-2020, accounting for normalized catastrophe losses of about five points, a slight benefit to core loss ratios from State National and other underwriting initiatives, and a slight decrease in the expense ratio. The projected results reflect our expectation of continued underwriting prudence despite increasingly competitive conditions in a number of Markel's lines notwithstanding modest rate increases post 2017 catastrophe losses. We also expect earnings growth from expanding noninsurance operations.

Markel maintains strong financial flexibility, reflecting its access to capital markets and partially offset by moderate debt leverage. The company's balance sheet is likely to continue to increase in intangibles and goodwill due to acquisitions, which can also result in higher leverage for a period of time. However, we expect a leverage run-rate of around 25% and fixed-charge coverage of at least 4x.

Other Assessments

We view Markel's enterprise risk management (ERM) framework as adequate with strong risk controls. Strong risk controls related to underwriting, pricing, and reserves underlie the company's track record of strong operating performance. The company maintains consistent underwriting discipline, managing premium rates and portfolio mix to generate specified returns based on targeted loss, combined ratios, and capital allocation. Managing the diversity and aggregations across investments, underwriting, and Markel Ventures is key to the group's risk profile, which elevates the importance of ERM to the rating.

We view Markel's management and governance practices as satisfactory because we believe the company has demonstrated an effective strategic plan and has been able to convert its insurance strategy, particularly in the U.S. where it has strong standing in the specialty and E&S markets. Execution risks emanate from the company's acquisitive strategy and from the ongoing build-out of private investments in non-insurance companies, which Markel has adequately managed so far. Although strong performing non-insurance assets with defendable positions can provide a good earnings source, the portfolio is still evolving and it will take a couple of years to fully assess the risk-adjusted returns and long-term benefit from this strategy.

We view Markel's liquidity as exceptional based on its significant liquid investment holdings at the insurance and holding-company levels. We don't expect the company to have any liquidity constraints in meeting its obligations in the next two years, including large catastrophe losses, and we expect it to maintain robust balances based on its conservative capital management philosophy. The liquidity profile is further supported by a $300 million credit facility.

Other Considerations

S&P Global Ratings applies a three-notch differential between its financial strength ratings on Markel's core insurance companies and its issuer credit rating on the holding company, which is standard notching for U.S.-based companies. The standard notching reflects the holding company's dependence on dividends from its insurance subsidiaries and structural subordination.

Although Markel benefits from the diversity of its legal entities' domiciles (which provides regulatory flexibility with regard to dividend capacity), a significant portion of the company's business and earnings is based in the U.S., which has a stricter regulatory regime. Also, despite the growth of noninsurance earnings (including Markel Ventures), which we expect will continue, the insurance operations will remain the main driver of group earnings. Based on allowable dividends, during 2018 Markel's U.S.-based insurance subsidiaries and its Bermuda subsidiary could provide dividends up to $880 million to the ultimate parent.

Markel has a history of significant cash and invested assets at the holding company, which totaled $2.6 billion as of March 31, 2018. Considering its acquisitive nature, we expect the holding company resources to fluctuate, although Markel is likely to maintain material cushion against any disruption in the dividend flow from subsidiaries.

Alterra Finance LLC's senior unsecured notes due 2020 are rated 'BBB'.

Ratings Score Snapshot

Markel Corp.	
Holding Company Rating	BBB/Stable/--
Financial Strength Rating	A/Stable
Anchor	a
Business Risk Profile	Strong
IICRA*	Intermediate Risk
Competitive Position	Strong
Financial Risk Profile	Strong
Capital & Earnings	Very Strong
Risk Position	Moderate Risk
Financial Flexibility	Strong
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Adequate w/ Strong Risk Controls
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	0
Group Support	0

Markel Corp. (cont.)	
Government Support	0

*Insurance Industry And Country Risk Assessment. NB: Support does not consider Ratings Above Sovereign criteria.

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

Related Research

- Bermuda Re/Insurance Quarterly Insights: Despite Record 2017 Catastrophe Losses, Reinsurance Price Increases May Vanish In 2019, June 5, 2018
- Reinsurance Pricing Was Up At The January Renewals, But Will The Momentum Continue Or Fizzle Out?, Jan. 23, 2018
- U.S. P/C Insurance Sector Outlook Remains Stable, But Something Has Got To Give, Jan. 23, 2018
- Third-Quarter 2017 Catastrophe Losses Are Becoming A Capital Event For Global Reinsurers, Oct. 13, 2017

Ratings Detail (As Of July 27, 2018)	
Markel Corp.	
Issuer Credit Rating	
Local Currency	BBB/Stable/--
Senior Unsecured	BBB
Related Entities	
Alterra America Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Alterra Capital Holdings Ltd.	
Issuer Credit Rating	
Local Currency	BBB/Stable/--

Ratings Detail (As Of July 27, 2018) (cont.)	
Alterra Capital UK Ltd.	
Issuer Credit Rating	
Local Currency	BBB/Stable/--
Alterra USA Holdings Ltd.	
Issuer Credit Rating	
Local Currency	BBB/Stable/--
Essentia Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Evanston Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
FirstComp Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Markel American Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Markel Bermuda Limited	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Markel Global Reinsurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Markel Insurance Co.	
Financial Strength Rating	
Local Currency	A/Stable/--
Issuer Credit Rating	
Local Currency	A/Stable/--
Markel International Insurance Co. Ltd.	
Financial Strength Rating	
Local Currency	A/Stable/--

Ratings Detail (As Of July 27, 2018) (cont.)	
Issuer Credit Rating	
Local Currency	A/Stable/--
Domicile	Virginia

*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.