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Ratings

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Research Update:

Fairfax Financial Holdings Ltd. Outlook Revised To Positive On Improving Earnings And Capitalization; Ratings Affirmed

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Overview

- Fairfax Financial Holdings Ltd.'s diverse insurance operations are leveraging market opportunities, while benefitting from the favorable re/insurance pricing environment, and should further improve the group's underwriting results.
- Investment earnings could benefit from repositioning of the portfolio as interest rates increase, and earnings from non-insurance operations should pick up as economic activity normalizes.
- We expect Fairfax's prospective capitalization and debt profile to strengthen from improving earnings and capital management actions, although execution risk persists.
- We are revising our outlook on Fairfax to positive from stable and affirming our ratings on the holding company and its operating subsidiaries.
- The positive outlook reflects continuing gains in Fairfax's operating performance and expected improvement in capitalization and debt profile.

Rating Action

On May 25, 2021, S&P Global Ratings revised its outlook to positive from stable on Fairfax Financial Holdings Ltd. (TSX: FFH; Fairfax) and its operating subsidiaries, and affirmed its 'BBB-' long-term issuer credit rating on the holding company. At the same time, S&P Global Ratings affirmed its 'A-' long-term financial strength and issuer credit ratings on Fairfax's core operating companies.

Outlook

The positive outlook reflects our expectation of strengthening in Fairfax's competitive position supported by operating earnings expansion, improving capitalization supporting robust growth, and a moderating financial leverage profile.

Upside scenario

We could raise our ratings on Fairfax within the next 12-24 months if:

- Capitalization improves sustainably to a level that is redundant at the 'A' confidence level;
- Financial leverage (excluding nonrecourse debt held at non-insurance operations) improves to below 35% (consolidated ratio less than 40%);
- The company's fixed-charge coverage ratio increases to comfortably above 4x; and
- Fairfax's diverse insurance operations continue to leverage market opportunities, with sustained operating performance in line with that of higher-rated peers.

Downside scenario

We could revise our outlook to stable and affirm the ratings in the next 12-24 months if the anticipated improvement in capitalization or debt profile doesn't materialize to the extent expected.

We could lower the ratings in the next 24 months if, contrary to our expectations:

- Capitalization is not redundant at the 'A' confidence level;
- Financial leverage (excluding nonrecourse debt held at non-insurance operations) is materially above 35% (consolidated ratio above 40%);
- Fixed-charge coverage is below 4x on a sustained basis; or
- The volatility profile changes due to an increase in risk tolerance or shifts in investment or business mix, resulting in higher risk exposure.

Rationale

The outlook revision reflects our expectations that the company's robust growth will be supported by improved capital adequacy that, along with disciplined underwriting and re/insurance rate increases, should drive gains in underwriting earnings. In addition, we expect financial leverage to reduce and coverage to improve progressively.

We expect Fairfax's prospective capitalization to improve such that it is redundant at an 'A' confidence level by the end of 2021 and through 2023. We anticipate expansion of operating earnings, both underwriting and investment, along with capital management initiatives (including asset monetization) to help build capital through our outlook period, which should support the company's business growth. Fairfax's sale of its 14% stake in Brit Ltd. to OMERS and the Riverstone Barbados sale (both expected to close later this year) help improve the company's risk-adjusted capitalization and reduce leverage. Fairfax has refinanced a few issuances with lower coupon debt. In addition, we anticipate paydown of certain outstanding debt instruments and of the remaining $500 million outstanding under the company's credit facility as of first-quarter 2021 will reduce debt below 2020 levels. As a result, we expect financial leverage and coverage ratios will progressively improve. However, there is market and execution risk, which could keep the capitalization and funding structure assessments toward the lower end of our range.

Fairfax's large diversified re/insurance operations, with an expanding market presence and an improving earnings profile, could provide uplift to the company's competitive standing, which is at the higher end of the current assessment. Fairfax's re/insurance operations have significantly grown in the past couple of years as they leveraged market opportunities benefitting from dislocation and rate strengthening. As a result, the company's 2020 gross premiums written (excluding run-off) increased about 12% to $19 billion from 2019. Furthermore, we expect the re/insurance rate environment to remain firm into 2022, which should further spur opportunities. This is highlighted by the first-quarter 2021 growth rate of 17% from the previous year period. Fairfax's combined ratio for 2020 was 98.9% (including corporate expenses and excluding run-off; 97.8% as reported) despite large COVID-19 pandemic-related losses and an active catastrophe year, with an attritional loss ratio that was significantly better than in previous years, in part helped by rate increases. The combined ratio of 97.0% (96% as reported) for first-quarter 2021 was affected by U.S. winter storms, although pandemic-related losses were much lower and the attritional loss ratio improved year over year but remained in line with that of full-year 2020.

Fairfax's interest and dividend income dropped by 12.6% to $769.2 million in 2020 from 2019, a trend that continued in first-quarter 2021 due to a high proportion of cash and short-duration bond portfolio. Furthermore, the company's focus on total returns underlies a large allocation to higher-risk assets, which leads to uneven returns and contributes to earnings volatility. However, Fairfax is well placed to deploy its assets in an increasing interest-rate environment. Also, considering high equity market valuations, we anticipate some gain harvesting. Therefore, investment earnings could expand as the company repositions its investment portfolio, although the redeployment is subject to economic and market conditions. In addition, a recovering global economy, although to varying degrees, provides uplift for the company's non-insurance operations.

We expect the premium growth (excluding run-off) to be low-double digits in 2021 and mid-to-high single digits in 2022-2023. We expect Fairfax's combined ratio (including corporate expenses and excluding run-off) to improve to 94%-97% for 2021, accounting for first-quarter winter storm losses, and additional pandemic-related losses, and about 93%-96% for 2022-2023. Furthermore, we expect financial leverage (excluding nonrecourse debt held at non-insurance operations) to progressively improve to below 35% (consolidated ratio below 40%) over 2021-2023 and for the fixed-charge coverage to improve above 4x.

Ratings Score Snapshot

Fairfax Financial Holdings Ltd. -- Ratings Score Snapshot

	To	From
Business Risk Profile	**Strong**	**Strong**
Competitive position	Strong	Strong
IICRA	Intermediate	Intermediate
Financial Risk Profile	**Satisfactory**	**Satisfactory**
Capital and earnings	Strong	Strong
Risk exposure	Moderately High	Moderately High
Funding structure	Neutral	Neutral
Anchor*	a-	a-

Fairfax Financial Holdings Ltd. -- Ratings Score Snapshot (cont.)

Modifiers

Governance	Neutral	Neutral
Liquidity	Adequate	Adequate
Comparable ratings analysis	0	0
Financial Strength Rating	**A-/Positive**	**A-/Stable**

IICRA--Insurance Industry and Country Risk Assessment. *This is influenced by Fairfax's strong competitive position anchored by its large re/insurance businesses.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

- Reinsurers Left Wanting More Despite Global Reinsurance Pricing Gains At January Renewals, Feb. 26, 2021
- Fairfax Financial Holdings Ltd., Dec. 11, 2020
- Fairfax Financial Holdings Ltd. Ratings Affirmed; Outlook Is Stable, May 29, 2020
- Fairfax Financial Holdings Ltd. Outlook Revised To Stable From Positive; Ratings Affirmed On Strong Capitalization, April 3, 2020

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Fairfax Financial Holdings Ltd.		
Issuer Credit Rating	BBB-/Positive/--	BBB-/Stable/--

Allied World Assurance Co. (Europe) Ltd.		
Zenith Insurance Co.		
ZNAT Insurance Co.		
United States Fire Insurance Co.		
Seneca Specialty Insurance Co.		
Seneca Insurance Company Inc.		
Odyssey Reinsurance Co.		
Northbridge General Insurance Corp.		
North River Insurance Co. (The)		
Hilltop Specialty Insurance Co		
First Mercury Insurance Co.		
Federated Insurance Co. of Canada		
Crum and Forster Insurance Co.		
Crum & Forster Specialty Insurance Co.		
Crum & Forster Indemnity Co.		
American Underwriters Insurance Co.		
Allied World National Assurance Co.		
Allied World Assurance Co., AG		
Allied World Assurance Co. U.S. Inc.		
Allied World Assurance Co. Ltd.		
Issuer Credit Rating		
Local Currency	A-/Positive/--	A-/Stable/--

Allied World Assurance Co. (Europe) Ltd.		
Zenith Insurance Co.		
ZNAT Insurance Co.		
United States Fire Insurance Co.		
Seneca Specialty Insurance Co.		
Seneca Insurance Company Inc.		
Odyssey Reinsurance Co.		
Odyssey Re Europe S.A.		
Northbridge General Insurance Corp.		
North River Insurance Co. (The)		
Hilltop Specialty Insurance Co		
First Mercury Insurance Co.		
Federated Insurance Co. of Canada		
Falcon Insurance Co. (Hong Kong) Ltd.		
Crum and Forster Insurance Co.		
Crum & Forster Specialty Insurance Co.		
Crum & Forster Indemnity Co.		
American Underwriters Insurance Co.		
Allied World National Assurance Co.		
Allied World Assurance Co., AG		
Allied World Assurance Co. U.S. Inc.		
Allied World Assurance Co. Ltd.		
Financial Strength Rating		
Local Currency	A-/Positive/--	A-/Stable/--
Allied World Assurance Co. Holdings, GmbH		
Zenith National Insurance Corp.		
Odyssey Group Holdings, Inc		
Crum & Forster Holdings Corp.		
Issuer Credit Rating		
Local Currency	BBB-/Positive/--	BBB-/Stable/--
Allied World Insurance Co.		
Issuer Credit Rating	A-/Positive/--	A-/Stable/--
Financial Strength Rating	A-/Positive/--	A-/Stable/--
Ratings Affirmed		
Fairfax Financial Holdings Ltd.		
Senior Unsecured	BBB-	
Preferred Stock	BB	
Preferred Stock	P-3	

Allied World Assurance Co. Holdings Ltd	
Senior Unsecured	BBB-
Fairfax (US) Inc.	
Senior Unsecured	BBB-
Odyssey Group Holdings, Inc	
Preferred Stock	BB
Zenith National Insurance Capital Trust I	
Preferred Stock	BB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.