S&P Global
Ratings

Press Release

# Various Rating Actions On Insurance Brokers Reflect COVID-19 Fallout

NEW YORK (S&P Global Ratings) April 20, 2020--S&P Global Ratings took rating actions today on four insurance brokers following a review of the 22 total brokers it rates globally. Insurance brokers make up the largest subsector in the rated insurance services sector. (For details on rating actions taken in other insurance services subsectors, see "Various Rating Actions Taken On The Insurance Services Sector," published April 6, 2020.)

The negative rating actions all stem from lower performance expectations as a result of the COVID-19-related economic downturn. We believe the sector will face some revenue and earnings headwinds as lower economic activity reduces insured exposures, but we expect most companies should be able to sustain credit measures within the current rating thresholds, based on S&P Global Ratings' economic forecasts and our company-specific forecasts. The four companies on which we took negative actions have two common characteristics: books of business that we believe may be susceptible to a somewhat outsize negative impact relative to the rated portfolio overall, and narrow cushions relative to our downside rating triggers with respect to leverage and credit protection measures.

We revised our outlooks on Alera Group Intermediate Holdings Inc., NFP Holdings LLC and subsidiary NFP Corp., and Achilles Acquisition LLC (d/b/a OneDigital) to negative and affirmed all ratings (see individual company research updates at links below). These three companies, in addition to operating at leverage metrics that are already somewhat tight relative to our downside triggers, are majority employee benefits operations (their benefits segments range from 50% to 90% of total revenue), whereas other rated brokers typically have greater weightings toward property/casualty (P/C) business lines. In the context of S&P Global economists' base-case forecast for a steep unemployment rise (14.4% in the second quarter of 2020 and 8.8% at year-end 2020, from 3.7% for 2019), we think the employee benefits segment may be susceptible to sharper organic growth declines than the P/C segment, given the segment's higher revenue reliance on client payrolls (most commission and fees for benefits brokerage are calculated based on payroll, whereas in P/C, this is largely captured in the worker's compensation line of business). Also, whereas the P/C market is benefiting from insurance pricing increases that can help mitigate the declining insured exposure base, the benefits book of business does not typically profit from medical cost inflation. Lastly, employee benefits commissions and fees are generally recognized on a monthly basis, so any top-line declines will be recognized sooner than declines in most P/C lines, which are typically recognized based on the effective policy date.

Separate from their benefits books, Alera, NFP, and One Digital also all have retirement/wealth management segments (ranging from 5% to 20% of total revenue), which we also believe could experience an outsize negative impact if material equity market declines are sustained, given the revenue's tie to assets under management. While we believe these companies are particularly susceptible to top-line pressures relative to the rated sector at large, based on book of business, resolution of the negative outlook will more so hinge on the extent to which the ultimate top-line pressures translate to EBITDA and leverage impact, based on each company's expense management, capital management, and strategic execution.

Meanwhile, we put our ratings on Confie Seguros Holding Co. on CreditWatch with negative implications. Confie Seguros is the only rated broker focusing on the nonstandard auto insurance market. The company is exposed to heightened risk of material revenue declines from consumers temporarily not purchasing auto insurance in reaction to loss of employment. Further, a large portion of transactions are made physically in Confie's 800-plus brick-and-mortar stores across the country, which adds another roadblock to new policy sales. Adding risk, Confie is one of the only brokers we rate with restrictive financial covenants (most brokers are covenant lite with springing revolver covenants only), and we believe the company has heightened risk of breaching its first-lien covenant, depending on the magnitude of EBITDA declines. We will resolve the CreditWatch over the next few months as we gain more clarity on the ultimate impact on Confie's operating performance, liquidity, and covenants.

At this point, we continue to believe that while the COVID-19 fallout will hurt the broker sector, the impact for most companies will be manageable within the ratings profile. Based on our most recent economic estimates and our expectation of a good first quarter for most of these companies, we think organic growth will generally be in the range of flat to negative mid single digits (with some positive and negative outliers) for 2020, considering weaker GDP, economic activity, and payroll, which reduces insured exposures (ultimately lowering the premium base from which insurance commission and fees are derived). Separate from the factors already mentioned, the degree of decline will also depend on each company's exposure to particularly hard-hit industries (such as retail, leisure, and aviation) and to small-business accounts generally, which are likely more susceptible to foreclosures. Aiding the sector, while new business will likely be weak, retention should hold up well, given that commercial insurance is generally nondiscretionary and naturally recurring. So while the commission may shrink on certain accounts as premiums fall, the revenue will not be lost with the exception of actual business closures.

On the margin front, the sector as a whole benefits from a highly variable cost structure with producer compensation tied to revenue production, which should serve as a self-correcting buffer to top-line declines. We expect flat to slightly compressed margins across the sector generally, though a few companies may even show margin increases. The degree of top-line decline and management-led expense strategies will play key roles in determining where margins fall, as some companies will likely be more aggressive and proactive than others in reducing discretionary expense line items (such as hiring, reduction in force, salary and benefit reductions, and business investment pullbacks).

Liquidity across the sector should remain healthy amid generally strong cash flow characteristics with relatively limited working capital and capital expenditure needs, highly limited debt maturities over the next two years, and good covenant cushions across mainly springing revolver covenants (with Confie as the exception). While some brokers, similar to companies in other sectors, have drawn down on revolvers in the last month or so, we view these actions as reflecting an abundance of caution in light of current market conditions, and not based on expected liquidity needs (beyond discretionary mergers and acquisitions). As the sector has been rapidly consolidating, the key cash use has been acquisitions, and we think a likely slowdown in merger and acquisition activity, combined with a tempering of valuations that until now have been rising, will also preserve liquidity and financial flexibility.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). We will continue to monitor the broker portfolio as the situation evolves and more economic and company specific information becomes available to assess any needed further rating or outlook actions.

For details on our recent rating actions on insurance brokers, see the research updates below:

- Achilles Acquisition LLC (d/b/a OneDigital) Outlook Revised To Negative On Impact Of COVID-19; 'B' Ratings Affirmed
- Alera Group Intermediate Holdings Inc. Outlook Revised To Negative On Greater Risk From COVID-19; 'B' Ratings Affirmed
- Confie Seguros Holding Co. Ratings Placed On CreditWatch Negative On Tough Operating Conditions
- NFP Holdings LLC, NFP Corp. Outlook Revised To Negative On Heightened Risk From COVID-19; 'B' Ratings Affirmed