



THE INSURANCE Insider

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Market skeptical over new retro fundraising efforts

The market is expecting little hard cash to emerge from a swathe of mooted retro start-ups in the lead-up to the January renewals.

As many as five entities have been seeking third-party capital to support new retro portfolios in 2020, with projected collective fundraising targets of above \$1bn, as sister title *Trading Risk* previously reported.

In a \$20bn market that has historically had around 75 percent or more ILS market share, this would be a significant inflow and potentially help to cap expected rate increases and redress the supply-demand imbalance.

But given the difficulty in raising capital for high-risk retro strategies right now, market participants said vehicles without a track record would face an uphill battle to secure funds, an improved rate environment notwithstanding.

Following two major loss years, 2019 is set to be complicated by some degree of lock-up on aggregate worldwide and sidecar business from the Japanese typhoons, meaning existing players will have to work hard to stay stable – although major players such as Aeolus and AlphaCat are expected to remain close to stable.

Arguably, the most significant long-term prospect among the five new players is the unnamed platform former RenaissanceRe and Aeolus executive David Eklund is working on.

New retro plays

Venture	Notes
Unnamed	Platform led by David Eklund; in talks with Warburg Pincus and thought to have \$500mn+ target
Lodgepine	Markel's ILS platform led by Andrew Barnard; plan to build out into non-cat lines after retro launch
Aspen	Working with Goldman Sachs on fundraise; already runs some capital markets sidecars
Fidelis	Was targeting smaller scale fundraise in the low hundreds of millions
Hiscox ILS	A broader high-risk addition to the platform's existing strategies
Combined target	\$1bn-\$2bn

Source: *Trading Risk*

Despite his pedigree and the fact he has been in talks with experienced (re)insurance sector investor Warburg Pincus over a seed capital investment, brokers are hedging their bets on whether this platform will emerge in time for 1 January.

Eklund himself has not yet been back on the front line of the market's pre-renewal circuit, suggesting that if it comes to fruition earlier in 2020, its 1 January capacity could be limited to cornerstone investors before a wider build-out.

Meanwhile, it has emerged that a fund in the pipeline from Hiscox is not, as first thought, a specific retro play.

Instead, the vehicle is a high-risk addition to its existing line-up of strategies targeted at mid-level and lower risk ILS investor appetites.

The remaining players that have been looking at new funds include Aspen, Markel's Lodgepine and Fidelis, as previously reported.

Aspen has not previously been a notable player in the retro market, though it has the Goldman Sachs seal of approval, while Lodgepine will have to combat prior associations with Markel Catco's disastrous losses.

Dislocation to persist

Even if some of the fundraising is successful, the retro segment is expected to face continuing dislocation and rate increases in January.

Any fresh inflows will be set against increased demand for cover and the withdrawal of Markel Catco, as well as reduced capacity from other ILS retro players.

Fresh demand could surpass \$1bn, sources said, including from new cedant Convex as well as carriers looking to expand existing programmes.

This is likely to include the likes of Everest Re returning to top up cover that could not be fully placed in the mid-year 2019 renewals, as well as others that have been growing gross portfolios this year.

Meanwhile, the lack of hedging capacity may prompt ILS writers to move their portfolios to higher-attaching levels,

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The reputational risk of retro

Retro pricing rose at 1 January 2018. And it rose substantially on those levels 12 months later as the Great Reload gave way to the Great Lockup.

Mid-year pricing this year was sequentially better again.

One underwriting source told this publication that right now retro could be a high-teens return opportunity based on an average loss load.

Scouting the opportunity, a number of executives and underwriting entities including David Eklund, Markel and Aspen are out there trying to raise money.

Nevertheless, the amount of successful new capital formation in the \$20bn-limit market is believed to be modest, though the final outcome is some time away.

For some years, the pre-dominant theory has been that significant capital markets money was waiting on the sidelines and would flow into the market if capacity were constrained and rates attractive.

So what is going on?

On one level, capital providers are simply taking the judgement that the risk-reward is wrong. For a high-teens return in a normal

year – better still in a zero-loss year – they are unwilling to accept the risk that they will be largely wiped out in a bad year.

And, after all, for many in the traditional market – which seems to have only incrementally increased its willingness to write retro risk – this is the judgement being taken.

More importantly, though, businesses are not managed by spreadsheets – they are managed by people. And people closely guard their reputations.

Retro is a fairly binary bet and although the returns may look good in a low-yield environment, the upside is modest when set against the potential reputational downside from having to explain losing big on a bet that has been disastrous in at least two of the last three years. Who wants to have to explain to their colleagues that they lost most of their capital on a Catco-like bet?

Secondly, the underwriting managers are trying to sell retro risk to fund managers as an asset class based upon modeled returns.

But after almost every major loss in recent years, problems with the modeling have emerged.

Hurricane Irma, two years of California wildfires and Typhoon Jebi have all shown that the industry did not fully have a handle on the loss events which could happen, or the impact that certain events would have on (re)insurance covers.

And finally, the connected issue of climate change is impeding fundraising. The California wildfires may well have demonstrated that when it comes to the modeling, the industry is shooting at a moving target.

Generalist investment committees are likely to feel uncomfortable about taking on climate risk when it is such a prominent concern, and right now the industry does not have good answers about its own understanding of climate change.

All told, it is not hard to see why new capital formation is proving an uphill struggle.



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combining with the withdrawal of Markel Catco to leave gaps in the supply of low-attaching cover.

Both the aggregate retro and quota share markets are expected to be hit by reduced capacity, as has been the case this year.

On the aggregate market, aside from the withdrawal of Markel Catco's pillared products, existing writers such as Aeolus and AlphaCat are tightening up terms.

On the quota share side, Stone Ridge's shrinking capacity has been well-signaled, but other funds such as Credit Suisse or Securis that allocate small shares to the segment are also rebalancing away from the market.

It has also been suggested that some of the mainstream US P&C players that write small retro quota shares have reduced appetite for 2020.

Some have suggested the cat bond market could be the ultimate beneficiary of reduced quota share capacity, with a glut of maturities next year set to free up more capital on the liquid side of the ILS market, potentially prompting increased transaction volumes.

Drawn-out renewal looks inevitable

The dynamics are leading retro buyers to head to market early as brokers urge them to line up cover.

But with investors still weighing up the opportunity, and after the experience of 2018 when early retro renewals were bound before many programs tipped into losses from the late October California wildfires, the renewal is expected to make little progress until much later in the year.

Investors are holding back from the aggregate retro market in particular, as extensive losses in 2017 and 2018 plus climate change concerns have raised questions over the adequacy of returns.

In some cases, recent loss years have more than wiped out prior-year returns to push longer term results into negative territory – such as at Markel Catco, where cumulative returns for ordinary shareholders since 2010 fell to a 53 percent loss at mid-2019.

However, this isn't going to be universally true. As of mid-2018, one US public pension scheme was reporting five-year annualised returns of just over 7 percent from Aeolus.

But Aeolus has historically made extensive use of hedging on its portfolios and will be

Retro ILS managers

Firm	AuM (\$mn)	Notes
Aeolus Capital Management	4,500	AuM includes mid-year Florida funds
AlphaCat Managers	4,156	AuM includes lower-risk/cat bond funds
Markel Catco	2,000	Exiting market
RenRe – Upsilon only	1,200	Grew in 2018; stable 2019
Kinesis	750	Multi-class
Tangency	265	Quota share
Lutece Re	250	BTG Pactual backing

Source: Trading Risk

facing the same tightening dynamic on its outwards portfolio as other buyers.

Although rates are expected to increase again in January by a meaningful amount, it remains to be seen if absolute retro returns will be seen as attractive enough to draw in opportunistic players such as DE Shaw or Berkshire Hathaway.

However, a further increase in participation from rated reinsurers seems likely after market share shifted somewhat away from the ILS market this year.

Some carriers with small retro portfolios have signalled a willingness to expand, but it is not yet clear how larger players such as Everest Re will look to navigate the market.



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Top-three ILS player boosts Bermuda operations

Credit Suisse ILS is building out its Bermuda underwriting operations as the top-three ILS manager continues to develop its own reinsurance infrastructure.

It has shifted existing staff and recruited Tokio Millennium Re's former chief risk officer (CRO) Andreas Kull to join the Bernina Re office, in a signal that as ILS managers develop more extensive in-house reinsurance infrastructure their staffing hubs may move in sync.

Bernina Re is led by former MS Amlin and Swiss Re executive Christian Bieri, who is looking to recruit another half-dozen underwriting specialists to join the office.

The firm has signed up Kull to serve as CRO, with the CFO role to be held by Michael Dennis, who previously led Guernsey-based Humboldt Re, Bieri told sister publication *Trading Risk*.

Former Securis head of non-life origination Fergus Reynolds was already lined up to take on a senior underwriting role, subject

to immigration approval, as *Trading Risk* previously revealed.

Bernina Re operates as an unrated Class 3a reinsurer, but the firm may look into the option of gaining a rating in the future, Bieri added. Credit Suisse ILS already has other rated paper vehicles, including the Arcus Lloyd's syndicate, Humboldt Re and Kelvin Re.

Bieri said that building up local origination and sourcing expertise would allow Bernina Re to move away from a fully outsourced model on the island.

However, it will still be using service provider Aon Insurance Managers for some day-to-day claims administration, finance and operations work.

Bieri said the expansion in Bermuda was mainly for regulatory reasons, and for European market access.

Bermuda has been granted Solvency II equivalence status, unlike Guernsey.

In the future, Bernina Re will focus on traditional reinsurance business while Credit

Suisse ILS will continue to act as investment manager and make all investment decisions for its ILS funds, Bieri explained.

The Bermuda team will focus on North American and global retro business, and work closely with a Bernina Re branch office in Zurich that will focus on international traditional reinsurance.

In Bermuda, in terms of local ILS managers, Nephila and Aeolus have always had headquarters on the island alongside smaller players such as Hudson Structured and Pillar.

In recent years, Securis and Elementum have built up the size of their local offices while Leadenhall Capital Partners made its first staff transfer to the island this year.

Bernina's new CRO Kull spent four years at Tokio Millennium as CRO after performing the same function at Axa Winterthur from 2008 to 2015. New CFO Dennis held roles at Aon Insurance Managers and EY before joining Humboldt.

Bernina is owned by the Credit Suisse ILS funds.

Reinsurers target further property cat rate

The 2020 US property catastrophe renewals may still be eight months away but reinsurers are adamant that further rate improvements are required, with one industry source commenting that increases are needed just to make the sector sustainable.

Speaking to *The Insurance Insider*, various senior industry executives said more rate was needed to offset both the recent spate of losses that have hit the sector and the improved understanding of the exposure carriers are facing from perils such as wildfire.

"We've taken losses for perils that we haven't modeled," one executive said.

Another said: "In 2017 and 2018 we had the first and fourth most costly cat years for the industry. Retro pricing certainly went up, and the primary has gone up, but reinsurance has lagged a little bit. We're now seeing that side catch up, and it needs to carry on."

As Guy Carpenter's latest US property cat rate-on-line index shows, rates have again been on the rise this year. But reinsurance underwriters feel more is still needed, especially in light of the losses that have hit in recent years.

Currently, the (re)insurance industry is facing a lower level of US cat claims than in

either of the two previous years. However, while the 2019 North Atlantic hurricane season is almost over, the California wildfire season is only at its midpoint with the potential for yet more destruction to be wrought. The last two years have brought with them consecutive record-breaking California wildfire seasons when it comes to insured losses.

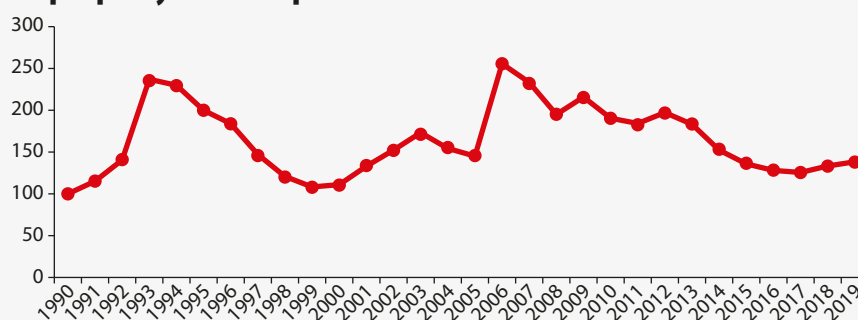
Even with the lower US cat claims tally, underwriters are insisting price increases are needed to help offset the losses suffered in 2017 and 2018, as well as to reflect the improved understanding of some exposures such as wildfire.

At the same time, reinsurers are themselves being squeezed by increased retrocession pricing. Consequently, reinsurers are adamant more rate is needed for property cat coverage.

It is unclear to what extent rates need to rise, but those that this publication spoke to felt it needs to be more than the 3.3 percent recorded by Guy Carpenter so far this year.

"Primary pricing seemed to pick up first, and then retro pricing picked up. But reinsurance has maybe been a little behind those two areas, but I think that is starting to even out and will have to continue," one source stated.

US property catastrophe rate-on-line index



Source: Guy Carpenter



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Guidance through shifting sands

The CEO of Aon's Reinsurance Solutions business, Andy Marcell, explains how the broker is helping clients navigate the changing dynamics of the market

How is Aon's Reinsurance Solutions business positioning itself for continued growth?

We've been growing consistently for several years. Core to what we do is delivering value to our clients and making sure everything we do differentiates us from our competition.

When we look to 2020, we still believe there's a considerable amount of uninsured risk out there so our New Ventures Group, which focuses on areas including government de-risking and intellectual property coverage, is dedicated to generating new capacity and solutions to meet the needs of the risk world.

We've always been innovative as a firm and we will continue to push the New Ventures Group and how we integrate it with Reinsurance Solutions.

The core differentiator for our business remains its scale, its innovation and its commitment to data and analytics excellence as a way of providing value to clients.

For a broking house that doesn't have that quantity of scale and data, it's hard to deliver broad value other than on specific, individual transactions.

What do you make of the talk about reinsurers becoming increasingly tiered and the number of carriers on panels reducing?

I don't think there is a deliberate move to cut the number of reinsurers by clients. If you're a global insurer you have benchmarks in terms of the quality, rating and capital adequacy that qualifies a reinsurer to be an adequate counterparty. Beyond that, global companies are looking for relationships across the breadth of the reinsurance they purchase and they tend to favor companies that feature broadly across those programs.

Naturally, the ability to offer broad geography and products tends towards the larger reinsurance companies. That's not to say that large companies don't have niche, specific reinsurance needs for certain lines, and they'll also go to companies they see as leaders in those segments.

Regional companies have a different view of their counterparties. They have solvency and capital requirements too, but they

tend to utilize brokers to a greater extent to monitor those financial strength metrics. They often want to build longstanding relationships with their counterparties.

Other than providing insight and analytics, structure and advisory services, our job as a broker is wrapped around providing choice to our clients on the execution of any particular transaction.

"To be relevant as a reinsurance broker you have to help your clients become more effective in executing their business plan"

What are the key talking points in the marketplace at the moment?

There are discussions around the original rate changes in the market and how long they will hold. Is the shift permanent and, if not, how long will it last? There are discussions around a tightening retro market and how that caused reinsurers to change their view of risk, the returns they were looking for and how it's now driving changes in behavior. There are two other considerations there – one is revamped funds and the second is ILS capacity and how much will re-emerge in 2020. But the most common topic is the changes in original rates, it will certainly be on everyone's mind. There will also be talk about innovation and technology and its impact on the industry.

Is InsurTech an enabler or a disruptor?

Throughout my time in the industry there have been challenges to the traditional model – cat bonds or ILS, for example – and now people talk about auctions and blockchain.

Everyone has a view on technology. Global insurance companies have their own technology initiatives – they have large resources and a number of relationships with technology providers. Lots of those companies are also investors in technology companies.

Companies that don't have those resources can turn to their reinsurance brokers to help

them analyze the plethora of providers out there and seek recommendations on which one might be best.

In this regard, we track all the InsurTechs we can and categorize them into distribution, risk selection and efficiency.

Regional companies look more to efficiency and distribution, and they also look for technology to help them select better risk. Global firms tend to follow all this themselves, and if it's an area that's truly innovative they will come and discuss it with us. In some cases we partner with them.

Pushing away from all the innovation would be the worst thing to do. We should embrace it and utilize the elements that are of value to our clients.

Can you tell me more about the client segmentation initiative?

To be relevant as a reinsurance broker you have to help your clients become more effective in executing their business plan.

The best way to do that is to identify a common set of issues around a common set of clients, and to improve the outcomes for those clients by generating a deeper understanding of their needs. That is not just around reinsurance transactions, but everything that impacts them.

For our regional clients, we're thinking about how can we help them solve problems in areas such as healthcare, asset management, pension advice and growth strategies. We have all those tools within the Aon family and our goal is to unite them in a single set of solutions. We call this Aon United. It's not a gimmick, it's real and we're working it hard. We're just doing more things in a better way for our clients.



Andy Marcell
CEO, Aon's Reinsurance Solutions business



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Capacity constraints will impact market into 2020: LGT

Dr Hilary Paul, partner and portfolio manager at LGT ILS Partners, says the firm is watching the retro space for signs of opportunity

Hilary, you represent an ILS manager – what's your market assessment and outlook?

The 2017 and 2018 catastrophe events in the US and Japan are still leaving their mark on some reinsurers and ILS managers, either in the form of adverse loss development from events such as Hurricane Irma or Typhoon Jebi, or through issues around trapped collateral in ILS, and also the reduced investor allocations triggered by these events. At LGT, we believe overall capital availability for the most highly concentrated exposures such as US wind, as well as “new peak” perils such as California wildfire, is still somewhat constrained. This translates into an attractive market environment with increased premium levels. For property catastrophe risk, we expect this situation to persist well into 2020, with a challenging renewal at year-end for some loss-affected participants.

Despite the impacts of 2017-2018, our asset base remains stable and we are well situated to supply our cedants with reinsurance capacity. In 2020, we intend to continue broadening our reach and growing our participations on quality reinsurance programs on behalf of our investors.

Two years ago, LGT ILS established a rated reinsurance carrier, Lumen Re Bermuda. How is the market accepting it?

To be precise, Lumen Re was actually established back in 2012 under the name Collateralised Re Ltd. Since then, LGT ILS has transacted well over \$15bn in collateralized reinsurance limit and this year, Lumen Re will write premium volume in excess of \$350mn. Over the years, LGT ILS has often faced cedants who wished to access capital markets capacity, but preferred rated paper for ease of operations and the straightforward transaction process. In order to optimally serve our cedants, LGT ILS injected significant equity capital into our Bermuda setup and rebranded the company to Lumen Re back in 2017.

Lumen Re continues to act as a collateralized carrier for the LGT ILS Funds – yet, rather than setting up individual trusts for each transaction, capital is retained within Lumen Re and assets are invested in short-term government paper. Capacity from LGT ILS thus remains collateralized behind the scenes, providing cedants with superior security. AM Best reconfirmed the strong credit rating of A/Excellent earlier this year. Lumen Re has received an overwhelming reception in the market; cedants welcomed the new product combining the best of both worlds – the superior credit quality from the ILS market and the ease of operations from the traditional market. Today, we are transacting the vast majority of all deals on a rated basis.

One of the hot topics is changing retro capacity. How do you view the opportunities for LGT ILS in the retro space?

At LGT ILS, we regard our capacity as a supplement to traditional reinsurance. We have always focused on trading reinsurance covers with large primary insurance companies, and the retrocession allocation has remained secondary. In the softer market prior to 2019, premium rates for retro often did not reflect an attractive (or adequate) compensation for the risk taken, and some reinsurers were at times simply arbitraging the market. Yet, with the disappearance and retreat of a few retro ILS funds and the resulting reduction of capacity, the market now seems to be going through a clean-up phase. We believe those reinsurers that depend on this capacity to meet regulatory capital requirements are in the market and willing to pay a correspondingly higher premium. Reinsurers that only used the retro market as an arbitraging facility will simply not buy the cover for 2020. As such, we expect that structures will be getting cleaner again with more occurrence placements to protect the capital base rather than aggregate covers for earnings protection, and defined territories rather than worldwide cover. At LGT ILS, we are currently watching this space carefully for signs of a clear opportunity. We are able to shift the weight of allocations quickly and may increase our share in retrocession if improvements on rate and terms do materialize.

As an ILS manager, are you also exposed to issues around climate change?

Investors are increasingly asking questions such as, “Is climate change responsible for the spike in hurricane losses in the US?” and, “Is climate change responsible for the extraordinary wildfires in California?” So yes, climate change has indeed become a hot topic for discussion! Yet, these questions have been high on the agenda of (re)insurance companies for more than a decade already. The revival of this topic now is linked to media coverage accompanying the large cat events and the growing attention given to environmental, social and governance topics globally. For our industry, changes in the severity and frequency of extreme weather events as well as a rising global sea level are two of the most central topics that have the potential to significantly impact (re)insurance results.

We are monitoring studies of climate predictions to understand the impact on weather, including potential changes in intensity of tropical cyclones and hurricanes, event clustering of European windstorms, and potential increases in the occurrence of both drought and flood events. Clearly, it will be key to consider changes at local levels – as certain regions become more susceptible to flooding, for instance, others may be increasingly dry. In addition, climate change cannot be studied in isolation from the exposure and trend toward increasing insured values. Hence, it is not possible to simply attribute one climate trend to the global landscape and we are following the research and market developments closely.



Hilary Paul
Partner / Portfolio Manager,
LGT ILS Partners Ltd. / Lumen Re Ltd.



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Marine liability loss spike spurs reinsurance pricing uncertainty

Marine reinsurers are grappling with widespread pricing uncertainty in the run-up to fourth-quarter and 1 January renewals, with a spike in marine liability claims adding weight to the thesis that rates must rise.

A spike in marine liability claims, including at least \$87mn of losses set to fall on the excess-of-loss program of the International Group (IG) of P&I clubs since its 20 February inception, has lent renewed urgency to calls from industry leaders that specialty reinsurance rates for most marine insurers must rise at 1 January.

In its pre-renewal P&I report, Tysers said the IG, which buys the largest marine reinsurance placement in the world, had absorbed claims of at least \$87mn above the \$10mn individual club retention in the six months between 20 February and 20 August.

Following the notification of these losses to the IG, a slew of claims have hit the US domestic marine liability market including a fire on board a Californian dive boat that killed 34 people, and the capsizing of a 200 meter-long car carrier off the coast of Georgia in the south of the US.

The increase in liability claims hitting the IG program follows a surge in claims for the 2018/19 policy period, which rose by 13.5 percent year on year to \$306.1mn. This comes amid expectations of at least low single-digit rate rises across most marine reinsurance accounts at 1 January.

The wider marine liability market is also set to absorb a claim of at least \$20mn after the *Solomon Trader* cargo ship in May foundered in the Pacific Ocean, spilling at least 75 tonnes of fuel oil on a World Heritage Site.

Speaking at the Monte Carlo *Rendez-Vous*, Munich Re board member Sven Althoff said marine losses from Typhoon Jebi and the Sassi superyacht fire at a Bremen shipyard would push up pricing in the market.

Fellow Continental reinsurer Swiss Re said it anticipated further rate increases for "loss-affected and underperforming" business.

However, the picture remains mixed as reinsurers prepare for year-end renewal discussions, with one senior reinsurance source insisting it was too early to be certain that the marine market would be forced to accept universal risk-adjusted rate rises.

"We are really just waiting to see what

happens," the source said.

"You see the news of all these losses, but we are holding back until we actually see the submissions," they added.

One marine liability underwriter canvassed said shrinking capacity had already curtailed his ability to purchase excess-of-loss cover.

"The decline in capacity has made it more expensive for us to buy our reinsurance. I suspect these are not the last withdrawals and it will be interesting to see what happens in the coming weeks," the source said.

In August, this publication revealed that Brit had closed its inland marine, yacht and Latin American operations in the US amid wider uncertainty over the marine rate environment across the US and in the London market.

That same month Swiss Re announced it would withdraw from the cargo insurance market and move its marine hull business from London to Genoa.

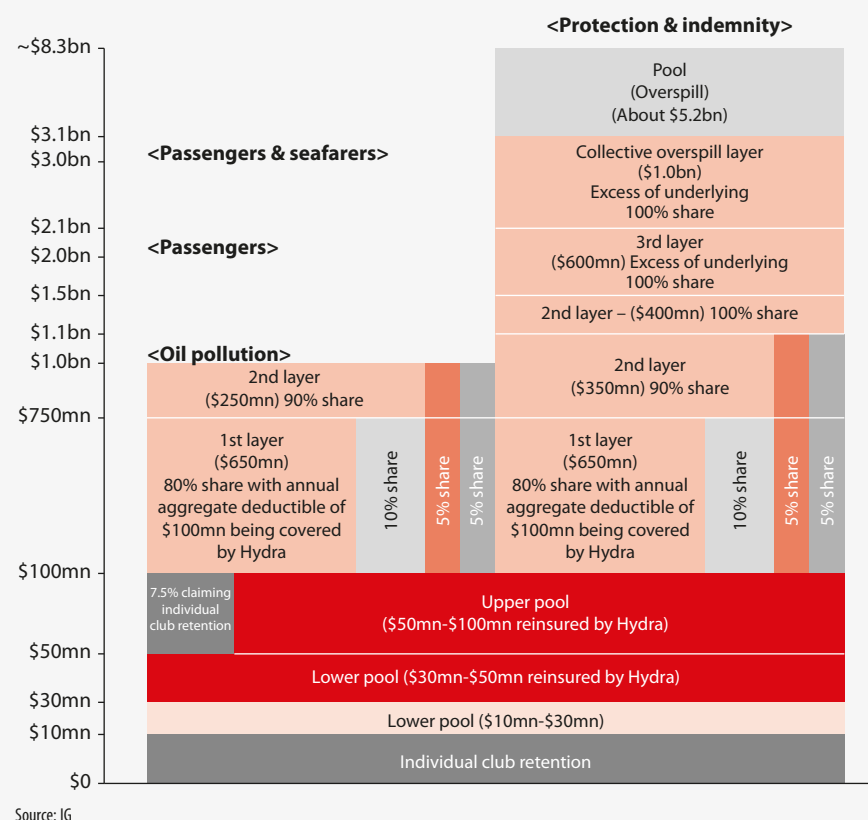
Shortly afterwards, Axis moved to retreat from four London-based business lines including marine, hull, management liability, power and product recall in a bid to reduce its exposure to underperforming lines.

The uptick in claims set to hit the IG and the wider marine market follows a warning from Allianz Global Corporate & Specialty (AGCS) earlier this year that the carrier has recorded an increase in the size and cost of claims from large vessels such as car carriers.

In its annual shipping safety review, AGCS said it had seen a spate of hull and liability claims caused by human error, including the collision between a Tunisian ferry and the container ship *CSL Virginia* last October, and the 2017 sinking of the *Kea Trader*.

Speaking at the Houston marine and energy insurance conference in September AGCS marine consultant Andrew McKinsey warned that seafaring standards needed to be preserved despite a heightened industry focus on autonomous vessels.

IG pool and reinsurance program – 2019/20 policy year





NEW OPPORTUNITIES AND LESSONS LEARNED

What segments of the market are proving attractive at the moment?

Mike Quigley, Munich Re America:

Generally speaking, the US property market has suffered for years from the effects of excess capital. Extreme competition across most property segments has led to inadequate pricing for both natural catastrophe perils and non-cat perils, resulting in elevated loss ratios in recent years.

We are starting to see firming in the large primary commercial property space, driven mainly by the larger players' re-underwriting activities. As some risks move back to the excess and surplus lines market from the admitted market, we are seeing positive impacts on both rate and policy terms.

Similarly, we see improvements in the homeowners market, especially in those states affected by catastrophic events over the past few years.

While these are positive developments for the property (re)insurance industry, I would not describe any segment of the market as hard at the moment. More work still needs to be done to address the growing threat of a changing risk environment and to keep inflationary impacts on property results in check.

Those carriers that have taken a leadership position in addressing soft market issues and that are leveraging technology and data to improve their risk assessment and pricing processes will be the winners in the long run as they are able to adequately navigate such underwriting cycles and outperform their peers. These types of cedents are much more likely to attract reinsurance support.

Doug May, Willis Re: While some lines of business are seeing significant rate, for example homeowners' in California, the unquantifiable nature of exposures like wildfire are producing conflicted results from the market. In some cases, new capacity is entering markets like California high-value homeowners' business on an excess and surplus basis.

Meanwhile, syndicated reinsurance placements are seeing significant price increases. In summary, both primary and reinsurance rate increases are significant in certain pockets mostly because of the uncertainty associated with loss potential.

Therefore, carriers with a firm view on risk that other insurers perceive as unquantifiable may find specific segments attractive.

What lessons have been learned in 2018 and 2019 that are pertinent to the US reinsurance industry?

Jason Busti, Axis Re: Client-centricity – making our clients' priorities our priorities – is essential. While this focus on a more client-centric model is not necessarily new, it is increasingly pronounced in today's environment.

The world is becoming more complicated, as are the challenges our partners face to

assess risk, grow their business, and protect their balance sheets. For reinsurers to remain relevant it will be necessary to also evolve the way we engage and understand our clients and the solutions we provide, all while managing our own risks and balance sheets.

Justin O'Keefe, RenaissanceRe: 2017, 2018, and now 2019 have proved to be high frequency for reinsured natural catastrophe losses around the world. At RenaissanceRe, our in-house team of scientists conduct detailed post-loss assessments to increase our understanding of natural catastrophe exposures and the impact changing risk profiles will have on our portfolio and required capital.

Our industry has dealt with events in multiple geographies and across perils, most notably the US Californian wildfires, Japanese typhoons, and Caribbean and US hurricanes. Our team learns from these events – specifically, we have implemented natural hazard models that have been incorporated within our proprietary REMS system.

First, we developed a new Florida homeowners model to take into consideration the material social inflation we have seen in recent Florida hurricanes. Second, we released a California wildfire model that factors in our view of the climate change impact in California that is producing increased frequency and severity of losses.

Third, we developed a revised view of risk for Japanese typhoon and our team will certainly have further enhancements when we conduct loss assessments from 2019 storms such as Faxai and Hagibis.

Finally, it has been important for us to

“For reinsurers to remain relevant it will be necessary to also evolve the way we engage and understand our clients and the solutions we provide”

Jason Busti

review the correlation assumptions within the Atlantic hurricane basin, specifically correlation between the Caribbean and US.

John Trace, Guy Carpenter: We have learned that reinsurers do differentiate based on actual results and overall trading relationships with cedants. They are looking to deploy capacity more selectively, but at the same time sense an opportunity to deploy more capacity as underlying conditions improve or portfolios are remediated.

Additionally, underwriters and investors have many new data points to evaluate based on recent loss activity. This includes an assessment of how catastrophe models and other underwriting assumptions matched up to the reality of recent losses. Everything from event behavior to individual components of loss drivers and the factors contributing to loss creep is being factored into going-forward underwriting strategy.

Reinsurers were also able to evaluate company response plans, access to loss adjusters and other “softer” factors as events unfolded. As it had been over 10 years since a major hurricane event impacted Florida, and California experienced record-breaking wildfire loss in 2017 and 2018, many companies’ large event preparedness was untested in recent years. These soft factors, as well as the application of more analytics-based findings, contributed to the significant degree of differentiation we saw in the 2019 mid-year renewals.

How has the market responded to the California wildfire losses seen in the fourth quarter of last year?

Jay Rosario, Munich Re America: The wildfire events in California over the past two years caused an unprecedented \$30bn in insured losses for the industry. And with climate change and the expansion of housing in the wildland-urban interface, we expect wildfire risk levels in California to remain elevated over the coming decades.

The industry is challenged to provide affordable coverage in this environment. Californians have seen insurance companies significantly restrict their writings in the wildland-urban interface where much of the destruction has been centered. Where coverage remains, insurance rates have spiked. The (re)insurance industry is taking a hard look at how to profitably underwrite wildfire risk in this changed risk environment. There is a push for improved

“Reinsurers are looking to deploy capacity more selectively, but at the same time sense an opportunity to deploy more capacity as underlying conditions improve or portfolios are remediated”

John Trace

underwriting data, both in quantity and quality, which will inform better risk assessment tools and models. There will also be a continued emphasis on loss mitigation through the combination of location-based risk controls, such as the maintenance of a non-combustible, defensible perimeter around a home, and more robust accumulation control at a portfolio level.

Trace: There are several factors contributing to the market response on wildfire. Losses from the 2017 and 2018 fires were each greater than any previous decade’s total loss. This level of loss occurring in back-to-back years, coupled with general concerns regarding the potential impacts of climate change, created additional sensitivity among reinsurers and investors around the pricing and aggregation management of this risk.

While pricing and overall capacity has been impacted, individual market behavior is varied, with some markets cutting back their participations and others increasing participations as they see market opportunity. Individual program results have also been varied as reinsurers considered individual account characteristics on a case-by-case basis.

May: Syndicated catastrophe reinsurance programs were generally completed, often below modeled loss cost (using AIR v6) on layers that attached closer to loss. As a result, we believe reinsurers may have either reduced their loss frequency assumptions, incorporated some expectation of subrogation from utilities, or simply not yet have incorporated AIR v6 into their pricing methodology. However, price increases on many loss-impacted layers were up by around 60 percent on a like-for-like basis. In other words, reinsurance pricing increased dramatically on most California-exposed programs even if the ultimate price still produces a

negative margin when evaluated based on model results.

How do you view the broking/carrier M&A landscape in the US reinsurance market?

Trace: The number of M&A transactions globally increased over 10 percent in the first half of 2019 according to recent reports, with the US the most active marketplace. Given current economic conditions whereby debt is relatively inexpensive, the dollar is strong and scale has as much appeal as ever, we expect the landscape to remain strong. That said, Brexit, trade wars and the volatility of the stock market are creating uncertainty that will have an impact on the marketplace.

On the carrier side, industry-wide profitability continues to create “dry powder” for carriers and adds to pressure from boards and shareholders. Diversification and scale appear to be the biggest drivers of the larger recent transactions, with carriers expanding into specialty lines, new distribution sources and/or new geographies.

CONTRIBUTORS



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John Trace, chief executive officer – North America, Guy Carpenter

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Hedge Fund Re: The irony factories

It is tough out there for total return reinsurers. Already under pressure from sub-par financial performance and weak valuations, over the past few months, the group has seen pressure dialed-up from updated PFIC tax guidelines, and an apparently less accommodative stance from AM Best.

Greenlight Re announced a strategic review back in August, in what appears to have been an attempt to head off criticisms around shareholder value creation.

However, the announcement brings into sharp focus the concerning track record of the group. The firms were originally marketed as an attractive entry point to gain access to “super star” hedge fund managers, with attractive tax features, and an opportunity to turbo-charge investment returns with underwriting gains.

Even so, following years of underperformance on both underwriting and investments, the two public “first generation” vehicles Third Point Re and Greenlight Re began this week with valuations ~30 percent below book value.

It is perhaps ironic enough that these “total return” firms have failed to deliver investment returns at levels even lower-risk corporate bonds have achieved or even in line with risk-free rates.

At any non-conflicted company, it is highly likely an underperforming investment manager would have been cut back or cut loose years ago. Though fees were modestly lowered at both last year, the fact remains that since its IPO, Greenlight Re has paid \$356mn in investment fees over 12 years while Third Point Re has paid \$409mn over six. A zero-cost strategic review from *Inside P&C* instead of Credit Suisse would put the money in index funds and pay the fees to shareholders instead.

The old joke about hedge funds is that they exist not to beat their benchmarks, but to extract fees for hedge fund managers. In that sense, what makes a “successful” hedge fund is not a track record of out-performing a relevant benchmark, but the ability to raise funds to earn fees from. In that regard – and perhaps that regard alone – the first generation of total return reinsurers have been a total success.

And here’s the added twist of irony. This use of corporate assets arguably in the service of a founding minority shareholder

“Our view is that the current valuations of total return reinsurers are unsustainable, and that the group are vulnerable to M&A and activism”

in a way that could be seen as happening at the expense of the majority of shareholders is the kind of conflict of interest that one could imagine both Third Point and Greenlight targeting in their sometimes assumed role as corporate governance purists via shareholder activism or as short

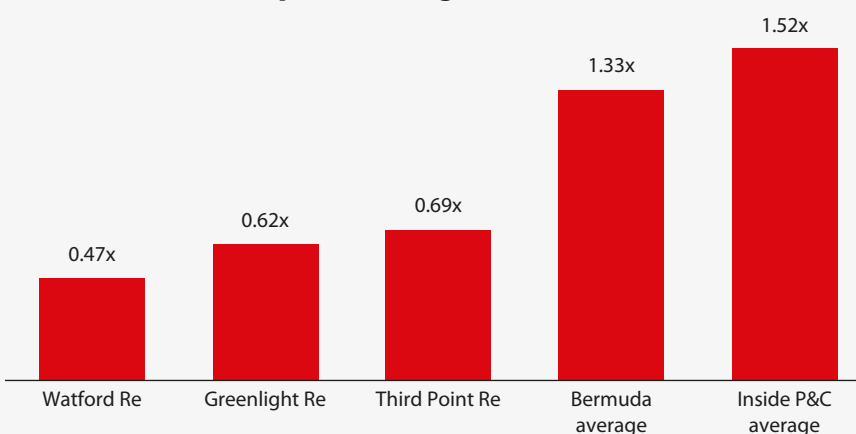
sellers. Ditto the use of a “cult of personality” to maintain access to capital markets.

Our view is that the current valuations of total return reinsurers are unsustainable, and that the group are vulnerable to M&A and activism.

Finally, it is worth noting not all total return vehicles are created equal, and the next generation of firms including ABR Re, Watford Re, and Hamilton all have distinguishing features. Even so, all are likely to face spillover scrutiny.

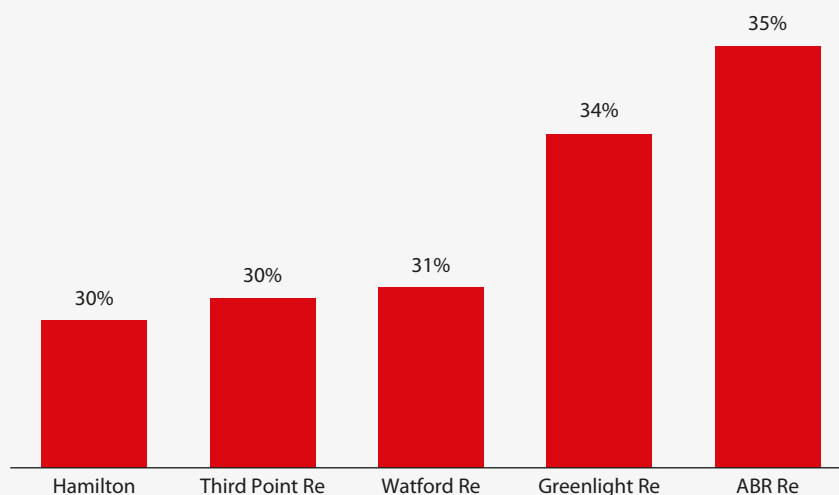
This is an executive summary of a longer form article published on 7 August. For more details see www.insidepandc.com

Price-to-book multiples at 2 August 2019



Source: Company reports, *Inside P&C*

2018 loss and LAE reserves as % of assets



Source: Company reports, *Inside P&C*



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Continuing the ILS evolution

Cat bonds were first issued in the mid-1990s. Today, a quarter century later, “alternative capital” is not that “alternative” anymore.

Some \$100bn of alternative capital has been committed to the insurance and reinsurance sectors, forming an integral part of many risk-transfer programs.

Some of the unique features of alternative capital still require a degree of customization, such as the collateralized nature of the structures, handling collateral releases, creating greater contract precision, mitigating second-event scenarios, etc. Nevertheless, working with experienced and interdisciplinary teams bringing together traditional reinsurance brokers, ILS experts and risk analytics has proven to be very successful.

However, it's not been all smooth sailing for alternative capital. The insured loss events of 2017 and 2018 put increased pressure on ILS products and providers to differentiate themselves and their value propositions.

With many ILS strategies either producing losses or breaking even in 2017 and 2018, today's institutional investors are demanding a better understanding of the potential impacts of climate change, valuations and how collateral is being utilized. The bar is rising, which from our perspective, is a positive development and sign of a maturing asset class.

In addition, technology and increasingly sophisticated capital markets investors are forcing the current insurance value chain to be more efficient.

We are seeing evidence of this from both sides. New distribution models are being developed to better reach end customers and reduce distribution expenses. Meanwhile, structures are being developed to more directly utilize institutional investors' capital.

These developments range from the creation of rated vehicles, to providing capital directly to insurance vehicles and, in the process, skipping some of the traditional value chain of insurer, reinsurer, retrocession provider and the associated expenses.

Going forward, we see two main trends in the ILS market:

First, the property catastrophe sector – where most institutional investor capital

is currently deployed – has become increasingly commoditized, and this is likely to continue. New managers creating new products within the property catastrophe sector need to find innovative ways to package risks that benefit investors and mitigate tail risk.

We expect that differentiation within these commoditized asset classes will be key. In addition, recent loss experience has also increased the ability to benchmark performance.

Second, we see greater investor interest in lines of business other than property cat. Of Lloyd's £35.5bn (\$45bn) of premium, only around 40 percent is property.

This provides room for future growth. A large portion of these risks are short-to medium-tail, allowing ILS to provide efficient capital support.

Such areas are also less capital-intensive, which can provide attractive economics to ILS investors. While this is an area where external vendor models provide less verification, actuarial analysis combined with select reinsurers' long-standing experience in these lines, could provide interesting access points for institutional investors.

We also expect institutional investors to closely evaluate the remaining long-tail lines of business which allow an asset strategy to be leveraged, including further development in the run-off space.

Considering the above developments, we expect institutional investors will continue to expand their participation in the (re)insurance market where value can be demonstrated.

Navigating the (re)insurance market and its various capital sources is becoming increasingly complex.

TigerRisk has been at the leading edge of ILS development.

Our mission is to understand all aspects of capital including ILS products, structures and providers and then match risk to capital using the most efficient solutions and partnerships.

“With many ILS strategies either producing losses or breaking even in 2017 and 2018, today's institutional investors are demanding a better understanding of the potential impacts of climate change, valuations and how collateral is being utilized. The bar is rising, which from our perspective, is a positive development and sign of a maturing asset class”



Philipp Kusche
Global Head of ILS and Capital
Solutions, TigerRisk Partners

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Split response to Florida reforms

The industry remains divided on how much Florida insurance reform has actually achieved, a panel of experts found during a debate at sister title *Trading Risk's* New York conference earlier this month.

A stronger hit from Hurricane Dorian could have taken the market back to its dislocated post-2004/05 status, said HCI Group's chief executive Paresh Patel.

But mid-year legislative reform left Validus Re executive vice president and head of US property underwriting Chris Silvester underwhelmed.

"Eighty percent of the problem has not been addressed," the executive commented.

Silvester estimated rates were up around 9 percent year on year on a like-for-like basis. However, Validus Re calculated that rates were down within a low single-digit range year on year after adjusting for higher loss-cost assumptions, he said.

This meant that pricing was still 35 percent below 2012 levels, versus 43 percent off ahead of Hurricane Irma in 2017.

"2012 was not a hard market," he added. "We don't believe the market charges enough rate to cover our loss costs."

However, Raymond James managing director Kapil Bhatia said that reinsurers rarely agreed that rates were adequate.

"[The rate increase] paid for the social inflation," he argued.

"We don't believe the market charges enough rate to cover our loss costs"
Chris Silvester

The state's legislature doubled the reimbursement level for loss-adjustment expenses (LAE) under the Florida Hurricane Catastrophe Fund to 10 percent. It also moved to address assignment of benefits fraud by setting restrictions on the use of such agreements.

Even so, Patel noted that it would be politically difficult for local insurers to raise rates to meet their rising costs given that reforms have been enacted.

There had been hugely disparate views in the market this year on what constituted adequate pricing, TigerRisk senior broker David Unsworth noted.

But from a broker's point of view, as

every program was fully subscribed, that was an indication of a market performing adequately, he added.

Next year, one factor that may influence the market is whether reinsurers end up with lower levels of retro quota share support, Silvester said.

As many carriers have shifted to being net underwriters in the Sunshine State – focusing on their returns after hedging – any lack of retro support could finally push them to reduce their gross footprint, he explained.

The experts also tackled the state of claims handling in Florida, after soaring LAE contributed to rising Irma claims in the past two years.

Patel said Florida insurers had taken steps to invest in claims handling after the experience of Irma, but results were uneven.

"Everybody has improved their game but not everybody is at the same level," he said.

Patel also argued that some cases where insurers can profit from internal claims handling businesses create perverse incentives and that these practices must be stopped.

Lloyd's cutbacks offer ILS opportunity: Libassi

A drive to re-underwrite and cut back business at Lloyd's is giving ILS players room to expand in the specialty insurance market, according to ILS Capital Management managing partner Tom Libassi.

Where Lloyd's has an expense ratio of 45 percent on certain insurance lines, Libassi said his firm could deliver this business for a 25 percent expense ratio, which he said was helping the company to target business that Lloyd's considered underperforming.

"All of a sudden business that is not attractive at Lloyd's, we have made highly attractive," he said at sister publication *Trading Risk's* conference in New York earlier this month.

Libassi praised ILS funds as the most efficient way to transform risk, saying acquisition costs and management fees total roughly 15 percent for standard reinsurance business – a figure no traditional company in the world could match.

The executive also said the firm had discarded the idea of trying to set up at

Lloyd's, due in part to the inflexibility of Lloyd's business planning procedures, but was considering other options to have rated paper.

"All of a sudden business that is not attractive at Lloyd's, we have made highly attractive"
Tom Libassi

"Part of what we are doing now is to look at how do we convert our class 3A collateralized reinsurance company to a rated balance sheet," he said.

It already owns a US insurance carrier that it is using to target non-standard auto business.

"We believe having a rated balance sheet is a benefit to us but we want control," he said.

Libassi also suggested that ILS firms should ask for additional premium payments from cedants that have trapped

capital past its maturity date.

His firm now has such clauses on half its portfolio, Libassi told delegates.

"Our target is 70 percent for next year. In 2017 that was zero – we are aggressively trying to get our money back," he said.

Libassi said charging additional premiums had been done in the reinsurance market "for years" and that cedants were accepting of the process and did not even "blink an eye". Additional premiums are also charged to hold capital in the cat bond market if claims are developing after a deal's planned expiration.

He noted that one outcome of trapped capital is that it dilutes the impact of rising yields for investors if they have capped their ILS allocation.

While those who invested in January 2019 for the first time were seeing "great double-digit returns", others who invested in prior years and had not been able to roll forward all their investments did not have the same degree of exposure to this year's portfolio and might only be seeing up to high single-digit returns, he explained.

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