

# Capital markets growth and innovations continue

**The influx of new capital into the (re)insurance industry constitutes the largest change to the sector's capital structure in recent memory.**

Over the past 24 months, approximately \$20bn of new capital has entered the market through investments in insurance-linked securities (ILS), funds and sidecars as well as the formation of hedge fund-related reinsurance companies and collateralised reinsurance vehicles.

The amount of limit placed utilising ILS and collateralised products continues to grow and some markets are broadening the line of business and product focus.

Capital markets activity in the first six months of 2014 continued along the growth trends seen last year, with a widening of the application of such capacity. Capital markets investors continue to be drawn to the (re)insurance space primarily due to the advantages it offers as a non-correlating asset class. Also, the recent availability of meaningful risk opportunities continues to drive investors to focus on the insurance-linked security space.

Capacity outstanding and size of the overall global property catastrophe limit continued to expand for all forms of capital markets capacity (144A catastrophe bonds, private catastrophe bonds, collateralised reinsurance and sidecars).

However, as capital continues to flow into the market from an ever broadening investor base, including pension funds, endowments, sovereign wealth funds and asset managers, the most notable development in 2014 has been the expansion and diversification of how this capital is sourcing the (re)insurance risk. The \$5.7bn of 144A cat bonds issued in the first half of 2014 marked a new six-month record, while the risk capital

outstanding grew to an unprecedented level of approximately \$20bn.

The growth in the utilisation of private cat bonds has continued at similar rates. In an environment of growing demand for capital markets capacity, GC Securities formalised its private cat bond approach in June 2013 with the development of the Tensai private cat bond programme in conjunction with Tokio Millenium Solutions' Shima Re Ltd facility.

## New cedants

New cedants continued to enter the cat bond space in 2014. Seven new sponsors utilised the 144A cat bond market for the first time in the first half of 2014. Additionally, several new sponsors entered the private cat bond market.

Cedants are increasingly attracted to capital markets capacity because of its competitive pricing and broadening indemnity coverage (with increasing inclusion of non-modelled perils). We have seen a growing request for the inclusion of certain terms and conditions, for example, hours clauses and definitions of named storms, from capital markets structures into traditional reinsurance placements.

The use of capital markets-based risk transfer capacity by public entities, insurers of last resort and compulsory catastrophe pools and disaster facilities also continued to expand, with deals completed for the Turkish Catastrophe Insurance Pool, Mexico's Fonden and New Zealand's Earthquake Commission.

Most large US insurers of last resort, such as the California Earthquake Authority, Florida Citizens, and the Texas Windstorm Insurance Association, have utilised capital markets capacity including collateralised reinsurance and cat bonds.

Capital markets-based capacity provides

cost savings to these entities, allowing them to utilise such savings to build surplus or buy additional coverage. It also improves coverage terms (transforming programmes from per occurrence to annual aggregate responses) and provides leverage to keep traditional capacity sources honest and to increase their willingness to adjust coverage terms that may not have been feasible without the use of capital markets-based risk transfer capacity.

Also, as public entities strive to reduce public debt, there is a clear benefit derived from limiting the risk that natural perils can pose to a state's balance sheet. At the time of loss, governments may be spared these enormous costs and they may have enhanced flexibility to finance economic and social development or reduce taxation.

## Developing trends

Capital markets capacity continues to innovate, as highlighted by the recent issuance of a cat bond by the Metropolitan Transportation Authority. This issuance, MetroCat Re Ltd, which came to market in July 2013, demonstrated the willingness of capital markets investors to assume storm surge and flood risk from named storms in a cost effective manner. Additionally, GC Securities' recent private catastrophe placement from the World Bank's new catastrophe note facility for the CCRIF shows the application for those sovereigns that need to protect against natural risks but whose limit needs may be more modest.

Up to this point (re)insurers have relied upon capital markets-based capacity primarily for property catastrophe risks (either for existing business or for growth into new areas). Moving forward, there is a question of the degree of expansion into longer tail, less volatile lines given the growing prevalence of hedge fund-backed reinsurers seeking to cover asset-intensive long-tail liabilities. With the dialogue just beginning at the C-suite level, further innovations are a matter of when...not if.



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