

Structured Capital Partnerships: An Evolution of the P&C Reinsurance Business Model



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- A new reinsurance business model is emerging in which risk and capital are coming closer together.
- Structured capital partnerships offer a flexible strategy for rated carriers to introduce a broader set of risks and longer-term arrangements to alternative capital.
- GC Securities* has recently structured partnerships for a Lloyd's syndicate and a legacy runoff business.

Over the past two decades, alternative capital has grown to represent almost a quarter of the total reinsurance industry capital. Insurance-linked securities (ILS), sidecars and collateralized reinsurance continue to provide valuable capacity to (re)insurers, corporates, and public sector entities to efficiently manage capital and risk alongside traditional market solutions, according to Shiv Kumar, President of GC Securities.

"However, even as alternative capital in the industry starts to approach the USD 100 billion mark, it comprises only a fraction of the total global assets under management. Given the diversification benefit of (re)insurance risk as an alternative investment strategy and the ongoing search for yield in the global credit markets, the flow of capital into the sector is unlikely to reverse in the near to medium term. This dynamic highlights the need for the reinsurance industry to innovate and pursue new strategies to utilize this source of capital efficiently," Kumar explains.

Kumar continues: "Despite their various strengths, the current alternative capital structures have several important shortcomings. It is difficult to access risk on concurrent terms and conditions on a collateralized basis in the reinsurance market. Alternative capital does not benefit from the underwriting leverage that the rated reinsurers enjoy. Funded structures also trap collateral upon a partial loss, thereby taking capital out of circulation. Therefore, there is a need for structures that allow investors to continuously access a broad portfolio of risks over time through a licensed and rated entity while leveraging their capital, with a potential exit strategy. For these reasons, a new reinsurance business model is emerging in which capital and rated carriers come together in hybrid structures and longer-term partnerships. This is facilitating the expansion of alternative capital in both size and scope toward whole account quota shares or enterprise-level partnerships covering a broader set of business lines beyond property treaty, including medium-tail specialty lines."

The hybrid approach has manifested itself over the years in more limited forms. Reinsurers have organically grown or acquired capital platforms that allow some sharing of risk across proprietary and third-party balance sheets. Conversely, some sovereign wealth funds and pension funds have partnered

with rated reinsurers. But the focus in these cases has been primarily on property catastrophe risk. Sidecars are the other popular hybrid product but these are typically limited to annual agreements.

"Strategic partnerships offer a flexible strategy to introduce a broader set of risks and longer-term arrangements. Carriers and investors may use the existing infrastructure to share in-force business or create new rated or unrated entities to underwrite new business. The agreement could provide reinsurers with potentially lower-cost capital and investors access to business that they would not otherwise be able to source or underwrite independently," says Kumar.

"Along these lines, GC Securities recently advised Canopus AG on its strategic partnership with Samsung Fire & Marine Insurance. The arrangement allows Samsung to access the Lloyd's market through the underwriting expertise of Canopus management. Furthermore, Canopus can leverage the substantial financial investment from Samsung and its franchise for its growth. In another example, GC Securities recently advised a company specializing in legacy runoff businesses on its structured partnership with ILS/pension fund capital," he adds.

"The key to these arrangements is a strong alignment of interests between the parties. In our advisory role we encourage transparency between both sides to build trust for the long term. We design these capital structures to optimize efficiency for both the carrier and the investor. We access our firm's reinsurance expertise, analytical capabilities, brokerage relationships and capital connections to ensure that the structure is responsive to the client's needs, and creates meaningful value for both sides that can be sustained. Whether it is a whole account quota share or an enterprise-level arrangement, a multi-year commitment or an evergreen investment, our emphasis is on the design of a robust partnership for the parties," he explains.

Kumar concludes by adding, "GC Securities is in active dialogue with investors and alternative capital pools seeking structured capital partnerships across the reinsurance space and can assist clients in navigating these opportunities."