Insight and Intelligence on the US and International (Re)insurance Markets

29 OCTOBER 2018
DAY 2
MONDAY

THE INSURANCE Insider

PCI

US casualty treaty rates set to improve at 1.1

Economics for writers of casualty reinsurance look set to improve again at 1 January as relatively modest reductions in ceding commissions combine with an uneven advance in original rates.

The market will also be characterized by a glut of new premium as a number of cedants, most notably AIG, bring major new proportional deals to market or top up existing quota share cover to take the overall spend billions of dollars higher.

A range of casualty sources described a reinsurance market that was entering its second year of improving terms on proportional deals, although the speed of change is slow and some fear momentum will be lost altogether.

The slight reversal in ceding commissions comes after many years of compound rate reductions that led ceding commissions to balloon to the mid-30s in many cases.

Reinsurance capital reached a first-half high at the end of H1, climbing 4.8 percent year on year to $365bn, according to figures compiled by broker Willis Re. The effect has been to restrain scope for rate rises, even in areas like casualty where performance has been relatively weak and alternative capital's impact has been limited.

With questions currently being asked about the scope for reinsurers to leverage losses from Michael and Florence, along with loss creep from Irma, to push for flat to increased rates on loss-free US cat, it seems feasible that the whole reinsurance market will be close to equilibrium at 1 January.

Conditions differ by sub-segment, but in the round "we are seeing a steady improvement in terms", one underwriting source told this publication.

Another said that they saw the market as "flat to modestly improving", with a third saying that since ceding commissions hit their ceiling they have broadly "come in by a point or two".

The differentiation by client that characterized improving terms for reinsurers in the second half of last year has continued.

One buyer said they were still able to secure renewals on expiring terms owing to the strength of their portfolios, and the willingness of underwriters to allow top-tier clients to renew unchanged was referenced multiple times by sources.

The change in market conditions after a period in which ceding commissions marched relentlessly higher reflects a combination of factors.

Meagre underwriting returns in casualty were sustained for a long time by reinsurers writing diversifying books with little additional incremental capital, and cross-subsidizing with cat books that generated returns on equity above 15 percent.

As well as the end of that paradigm owing to the structural change to cat returns, there has been increasing loss emergence within US casualty lines after a long period of benign claims inflation.

This first became evident in auto lines, particularly in commercial auto where results remain extremely challenged, but casualty market sources have said the same development has now spread to other lines of business.

These include primary casualty, lead umbrella and primary directors' and officers', according to underwriting sources.

There are signs of upwards rate momentum in casualty insurance lines, excluding workers' compensation, with commercial auto up 8.3 percent, umbrella up 1.5 percent and general liability ticking up 0.8 percent in the second quarter, according to numbers from the Council of Insurance Agents & Brokers.

Broking sources have suggested there may be signs through Q3 of an acceleration in rate movements – although this is yet to show up in published numbers – as AIG in particular stiffens underwriting guidelines, with a number of other lead markets also showing resolve.

Nevertheless, it is questionable whether rate rises are running ahead of loss-cost trends except in certain pockets of the market.

Chubb, which recorded rate rises of 3 percent and 2.5 percent in the second and third quarters respectively, warned on its recent conference call that there were areas where price rises were not keeping pace with loss inflation.

Casualty treaty writers said, though, that there were areas where rates were firmer and flowing through to improved margins for reinsurers. Others merely seized on the fact that rates were in modestly positive territory.

The muted nature of the firming reflects the reluctance of established reinsurers to scale back their books as conditions start to improve.

CONTINUED ON PAGE 03

INSIDE

25

The number of years we've been proud to be your partner.

The past 25 years haven't been about us, they've been about you. Understanding your needs, recognizing your unique risk challenges and developing solutions - together. Looking back on our history, it's not the highs and lows that stand out, it's the familiar faces and long-term relationships that we're most proud of.

From our company to yours, thank you for your business. It's an honour to celebrate 25 years of meaningful partnerships.

25 YEARS

RenaissanceRe

renre.com

AmTrust begins to explore options for vast quota share

AmTrust has begun approaching the casualty reinsurance market to explore its appetite for a major new quota share that could be the biggest deal brought to market in years, *The Insurance Insider* can reveal.

The Nasdaq-listed insurer currently cedes around 40 percent of all the business it writes to sister company Maiden Holdings via a quota share.

As previously revealed by this publication, the board of Maiden has placed the business up for sale, with Bank of America Merrill Lynch running a process following approaches from legacy players Catalina and Enstar.

Sources said there are live players involved in the sale process that may be interested in keeping the AmTrust quota share going, but if a legacy carrier were to acquire Maiden it would terminate the deal.

It is understood that AmTrust's brokers have begun warming up the casualty market with a view to potentially replacing some or all of the proportional deal with a commercial third-party deal.

Sources said Aon is working on the placement. One other broker – believed to be a boutique – is said to be working alongside the big-three intermediary, but the name could not be confirmed at the time of going to press.

Details are scant, but two sources suggest that if AmTrust went ahead with a placement it could see upwards of $2bn of premiums ceded. A third senior source said it was likely that ceded premiums would comfortably exceed $1bn.

However, discussions are still at an early stage given that the situation around the Maiden process is fluid.

Given established relationships and the huge reinsurance recoverable between the two companies, AmTrust is likely to continue with at least some version of the quota share if Maiden is sold to a company that wants to keep it going.

A decision has to be taken around whether to renew the longstanding AmTrust-Maiden quota share in January, with the current deal set to roll off in June.

Should greater clarity on the Maiden sale process emerge ahead of the January deadline, the two parties would then be in a position to take a call around the future of the quota share.

AmTrust and Maiden have already extended the current period and terms of the quota share at least once to give both sides more time to take a decision about its future owing to other corporate developments.

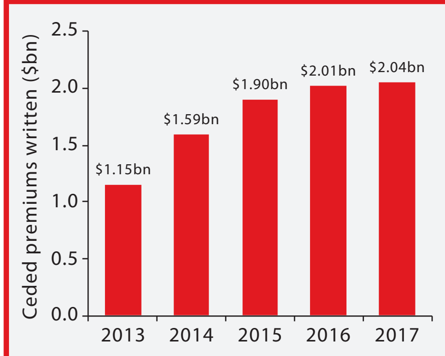
The former business is currently awaiting the close of a $2.95bn take-private deal backed by Stone Point.

Maiden, meanwhile, has passed through a series of travails around its rating, leadership team and results, which led to the sale of its third-party business in two transactions to Enstar and TransRe.

The Karfunkel-Zyskind family founded both AmTrust and Maiden, and AmTrust CEO Barry Zyskind remains chairman of Maiden, although the family's holdings in the firm have been diluted over the years.

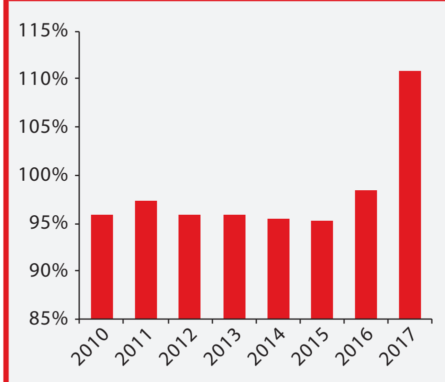
AmTrust suggested earlier this year that it was open to utilizing the commercial reinsurance market when it struck a deal with Everest Re to cede 35 percent of its program book to the Bermudian.

Premiums ceded by AmTrust to Maiden under the QS agreement



Source: S&P Global, company reports, *The Insurance Insider*

Maiden segmental combined ratio: AmTrust quota share



Source: S&P Global, company reports, *The Insurance Insider*

CONTINUED FROM PAGE 01

One reinsurer said that incumbent underwriters were unwilling to push on rates because they did not want to risk losing their books to challenger markets looking to establish themselves.

As such, they were satisfying themselves with a managed and staged reduction in ceding commissions.

One key feature of the renewal will be a surge in demand for new casualty quota shares.

One underwriting source estimated the new demand as running to billions of dollars of premium.

However, there were differing perceptions of this new business in different parts of the market.

Some sources perceived it as a flight from earnings volatility and a move towards a model that embraced the stability of fee income. Others suggested they represented low-margin arbitrage plays.

The pricing on the deals is likely to be highly dependent upon whether Munich Re and Swiss Re – the dominant proportional writers in the market – choose to participate.

Sources suggested the carriers have been careful writers of additional US casualty quota share business over the last year or two, but as ever there will be a temptation for them to produce growth to show analysts.

Munich Re, Swiss Re and Hannover Re all reported high first-half growth due to writing a small number of major quota shares.

Big question: Bermuda M&A

Do you expect to see more Bermudian (re)insurers sell themselves in the coming 12-24 months?

Axel Freiboth, managing director, North America, Hannover Re: We have seen a number of Bermuda-based reinsurers involved in mergers and acquisitions. One of the reasons behind that is that size matters more than before. Clients are either reducing reinsurance panels or looking for highly tailored agreements. Furthermore, Bermuda-based reinsurers tend to be more exposed to catastrophe reinsurance and that's where we are seeing the fiercest competition and pricing pressure in the reinsurance market. I wouldn't be surprised to see more consolidation going forward.

John Welch, CEO, North America, Axa XL: I would expect the pace of M&A with respect to the Bermuda specialty/reinsurance model to accelerate in the next year. The hyper-competitive property cat market is not expected to change without a significant amount of loss, so the over-dependence on this market by Bermuda reinsurers will necessitate their partnership with larger more diversified companies.

Jean-Paul Conoscente, CEO of reinsurance, Scor Global P&C: There have been two transactions involving Bermuda-domiciled companies announced recently, both of which involved small carriers whose capital appeared to be inadequate. With recent tax and regulatory changes and the near-elimination of excess profits in cat reinsurance, the Bermuda model is very challenged, even though most cat reinsurers started diversifying several years ago. Cedants increasingly expect their reinsurers to write across all lines of business, in a long-term partnership approach with local expertise, which gives global composite reinsurers a distinct advantage.

Chris McDowell, CEO, Willis Re Bermuda: At the right price, any business is available. So, while the remaining standalone Bermuda players may wish to remain independent, in the face of a compelling bid, they would do what's best for their shareholders. The recent territorial tax changes in the US now make owning a Bermuda subsidiary far more attractive for US holding companies than under the old regime. Moreover, Bermuda companies have diversified their business models both geographically and by line of business, making themselves potentially more attractive to outside buyers. Bermuda's regulatory environment is sound, respected and business-friendly. So, there are a lot of good reasons for companies in other jurisdictions to want to buy a meaningful Bermuda player.

David Priebe, vice chairman, Guy Carpenter: In light of the industry's capital position and the pressure management teams are facing from boards and activist investors, continued consolidation is certainly a consideration. Many carriers view diversification – both in terms of products and geographies – and size as competitive advantages. So as the number of acquisition targets continues to shrink, I would not be surprised to see some of the remaining companies bought or merged.

It is possible, however, if you have been strong enough to stay independent for the past few years that this can continue for the next few. This said, as AIG, Axa and The Hartford have shown this year (as well as Sompo, Liberty Mutual and MSI before), there continues to be a lot of appetite from global P&C insurers to acquire reinsurance and specialty platforms, which is the trademark of Bermuda (re)insurers, so more could happen if the price is right.

Do you think other global insurers will diversify into specialty (re)insurance as AIG and Axa have?

Welch: Global insurers, or those that aspire to be, need to ensure relevance with the end customer. In many cases, standard property and casualty lines are unable to satisfy the evolving needs of these customers, so a strategy that includes an expanded product offering with specialty lines is a necessity.

Brian Secrett, chief underwriting officer, Tokio Millennium Re: There is a tide in the participation of global insurers in the reinsurance business. Pools of capital will look for a good match with pools of risk. It is becoming increasingly important for reinsurers to facilitate an efficient match between risk and adequate capital irrespective of the source of this capital. A clear opportunity exists for reinsurance companies offering both traditional reinsurance and capital market solutions to successfully marry their catastrophe risk-taking with alternative pools of capital.

Conoscente: There are very few – if any – examples of companies with insurance in their DNA running large reinsurance operations successfully over the long term. All of the tier one reinsurers are either independent stock companies or extremely autonomous parts of conglomerates, with their own management and access to capital markets. No top reinsurer is embedded inside an insurance company.

They are fundamentally different businesses, and investors are rightly skeptical of companies that think they can do both profitably. Reinsurance requires sophisticated understanding of risk and capital and small numbers of highly skilled employees. In contrast to reinsurance, most primary insurers manage and service local customers or agents. They do so with tens of thousands of service staff such as telephone representatives, field adjusters and billing teams.

An insurer may have a side business doing reinsurance. It never gets too big – it can't, because it would contribute too much volatility. History shows that eventually the reinsurance business gets sold or spun-off when the insurer cleans out its cupboards.

Jerome Halgan, CEO, Arch Re: The fact that AIG and Axa did it puts more pressure on the others to move as well. In addition, if the theory that autonomous cars will shrink motor premium – a large portion of global insurers' premium – proves true, then that pressure to diversify will increase.

McDowell: Bermuda companies certainly represent a more volatile business model than has traditionally been desirable for life players. However, Bermuda companies have lowered their volatility profiles through diversification as cat pricing has moderated. Whether that diversification is enough to entice more players into the M&A game is anyone's guess.

How will Bermuda adapt to the consolidating landscape given the new challenges to the traditional reinsurance model?

Secrett: Bermuda is doing what it does best, finding new ways to respond quickly

CONTINUED ON PAGE 06

CONTINUED FROM PAGE 05

and add value to the business sectors that operate in the jurisdiction. Bermuda is best suited to high volatility, low transaction cost, high volume per transaction business.

Bermuda is also making a move to be a leader in InsurTech and digital assets with legislation and a regulatory framework in place to include a regulatory sandbox concept. Bermuda is doing what it can to future-proof itself for consolidation and transformation of the industry.

Freiboth: Consolidation will not change the landscape in respect of the distribution of capital and therefore the capacity provided to the natural catastrophe market. The consolidated companies are in a position to provide the expiring capacities. The question would be how acceptable that is to cedants. Consolidation of Bermudian companies would reduce the number of players on the island and it remains to be seen what impact this would have on the Bermudian marketplace.

Priebe: The Bermuda market has always been a leader in innovation. As traditional reinsurance business models evolve, companies are actively looking for new coverages to write such as cyber, flood and mortgage; new sources of business such as MGAs and InsurTech firms; and new income streams such as sidecars, collateralized reinsurance, ILS and third-party managed funds.

Halgan: By continuing to innovate, Bermuda continues to be a very important (re)insurance hub and as long as it is able to keep its talented workforce it will continue to be so. For example, although the number of traditional reinsurers has shrunk by two-thirds from its peak, driven by M&A, property cat cedants have more clients to see than they did back then as Bermuda as has been the place of choice for ILS vehicles.

Do you think the total return reinsurer model will become more attractive for capital looking to buy and diversify? How do you see equity investor demand for sidecar vehicles?

Halgan: I think the total reinsurer model, like any other reinsurer, can be very attractive for capital if it has a successful track record. In some way it borrowed its business model from the likes of Berkshire Hathaway, Fairfax or Markel, which have done incredibly well. The issue right now is that some of the total return reinsurers have had mixed results over the past few years, which has been accentuated by the difficult trading conditions that have prevailed over that period.

> "There are very few examples of companies with insurance in their DNA running large reinsurance operations successfully over the long term"
> *Jean-Paul Conoscente, Scor*

McDowell: The total return model has been with us for some time in the form of Berkshire and Fairfax, both of which have proven to be shrewd investors over a very long period. Both of those companies have enviable track records. So, it's clear the model can work when well executed. However, when a highly leveraged investment portfolio underperforms, the impact on surplus is disastrous. For total return vehicles that are affiliated with traditional players to outperform, they not only need to beat their benchmarks, they also need to overcome the tremendous costs of outside insurance and investment managers. So, I think it's unlikely that more affiliated total return vehicles will form.

Priebe: The sustainability of the total return reinsurer model remains to be seen. But as a challenging (re)insurance market and underperforming investments continue to impact publicly traded companies, and investors' demand for sidecars and other areas of the (re)insurance risk class continue to grow, it will be interesting to see what happens. A number of total return reinsurers that were created in partnership with established players are now reaching the next phase of their existence, and it will be interesting to see if they go public – and at what price multiple – or if they sell to existing players.

Freiboth: Most total return reinsurers have not met their return goals over the last few years. While conceptually this could be a good play, the concept is not fully proven. Traditional approaches, on the other hand, have worked well for decades. This would suggest that the sidecar approach may be the better play, at least from a long-term perspective. However, we will certainly have players that keep trying to prove that the total return reinsurance model works.

Why do you think the momentum generated at the start of the year has died out in terms of M&A on the island?

Halgan: I am not sure the momentum has died out – the fact is that there now only a few Bermuda-based reinsurers left for whom M&A would currently be attractive.

McDowell: I'm not sure I'd characterize M&A momentum as dying out. The Markel-Nephila merger was fairly recent, if not traditional. The transactions to date have been quite large, and one shouldn't expect activity of that kind every day.

Priebe: It is due to price and social issues, which are the two biggest hurdles to getting any merger or acquisition done.

Freiboth: Has the momentum really died out? The fact that the number of potential takeover targets has been reduced might also play a role here.

CONTRIBUTORS

Jean-Paul Conoscente, CEO of reinsurance, Scor Global P&C

Axel Freiboth, managing director, North America, Hannover Re

Jerome Halgan, CEO, Arch Re

Chris McDowell, CEO, Willis Re Bermuda

David Priebe, vice chairman, Guy Carpenter

Brian Secrett, chief underwriting officer, Tokio Millennium Re

John Welch, CEO, North America, Axa XL

Adapting to a challenged market

Aon's Amanda Nguyen on the state of the casualty reinsurance market

What are your expectations for 1 January renewals in US casualty business?

If we were to take a very generalized view, based on loss experience and available capacity, our overall expectations for 1 January are for a relatively flat renewal. However, as always, we would highlight that each of our client programs is viewed on its own merits and has its own individual and unique dynamics.

Over the past year, we have observed pressure on ceding commissions on professional liability; however, we have held the line for clients to be flat or slightly down but still near historical highs. Any reductions were largely a function of challenged results in pockets of the underlying business. We have also seen changes to coverage terms and conditions that are broader than average. We don't believe and haven't observed generally that there is sweeping market change.

We track our renewals on the pro rata business. Last year when commentators were rather pessimistic on casualty, on average, across fourth-quarter placements including 1 January renewals, our portfolio was holding up very well at less than one point ceding commission reduction on average.

The original business is experiencing varying degrees of stabilization or firming. We generally observe firming in national accounts umbrella and improvements in nearly all professional lines, stabilization in Workers' Compensation, while the market still remains relatively soft in environmental, for example. Auto remains one of the rate change leaders because of the change in dynamics of the sector over the past few years. Where we see the original business firming we believe reinsurers will take that into consideration.

We do not expect hurricane activity to date to have a direct impact on the casualty reinsurance marketplace.

How, in your opinion, has recent M&A activity changed the industry? How will competition change, and will it be for the better or worse for customers?

We have seen a significant volume of M&A transactions in different sectors of our industry over the past few years, and most of these firms will be stronger as a result. From a capacity perspective, we do not think this will cause any kind of dislocation for our reinsurance clients, as the capital remains readily available to them, presenting some great opportunities for capital optimization and growth.

In terms of the latter, one of our major roles as a professional services firm is helping clients to identify and seize growth opportunities. In this regard, we have had great successes in a number of areas; one example is in government de-risking, in areas such as US mortgage credit, where we have introduced a whole new profitable line of business to a wide range of (re)insurers.

How can reinsurers adapt to this changing landscape?

Helping brokers solve client problems in creative and innovative ways is critical. Strong coverage and value-added services along with maintaining effective relationships and regular communication with your broker counterparts outside specific transactions will help reveal these opportunities.

The key is to enhance relevance in an environment of heightened competition among reinsurers. In casualty, in particular, capacity is abundant and that's not expected to change by any stretch. With respect to alternative capital, we have seen limited direct impact of alternative capital on the casualty space. It is possible that there may be some auxiliary impact, but we believe it is difficult to forecast its full and longer-term influence.

It's important to talk about demand. For traditional reinsurance products, we have seen increased client demand in several areas of the market. Further, we've seen significant demand for products addressing historical liability like adverse development; this increased interest is in addition to the large news-worthy transactions over the past several years. We don't see these trends decreasing in the near term.

Carriers varying in size and scope are valuing reinsurance to mitigate risk and for capital management. Aon provides a broad range of capital advisory and ratings advisory services, and these can be of great benefit to clients in determining their optimal level of reinsurance buying for historical liabilities or their current portfolios.

Where have you seen improvement in some of the more challenged traditional lines? What has been a catalyst for that?

In the original casualty insurance business, when taking a very broad view, there has been some degree of rate strengthening across a wide swath of classes, although programs are always based on their own individual dynamics. The level of strengthening has varied by line of business, with auto leading.

As mentioned previously, auto has publicly been a challenging line in the industry, and on average it continues to see strong rate improvement – in some cases, significant continued year-over-year improvement. Outside of auto, newsworthy events have increased attention on large account pricing and limits deployment, and we have seen improvements for many carriers in key terms and conditions.

From your understanding in a casualty capacity, what Aon initiatives have been most successful in the past 12 months?

Aon United is a cornerstone value of our organization, whereby we work together for our clients' benefit. Bringing all of Aon to our clients has been a huge success and this cultural transformation has been exciting for colleagues.

We have developed wide-ranging capabilities in casualty and continue to invest in requisite tools and talent, and our intensive Analytics efforts have achieved much success.

From traditional reinsurance products for ongoing liabilities to programs addressing historical liabilities, we have seen increased demand in the market and are continuously working side by side with clients to devise differentiated solutions.

Amanda Nguyen
Senior Managing Director - Treaty Broker, Aon Benfield

PartnerRe

Keeping your goals front and center.

partnerre.com

25 YEARS

ILS sector considers disruption, flood and M&A

ILS managers should regard the InsurTech sector as a source of risk origination and efficiency gains, according to Adrian Jones, deputy CEO of P&C partners for ventures and strategic partnerships at Scor Global P&C.

But the insurance sector "is not a market that's ripe for disruption the way that ILS disrupted reinsurance 10 years ago", he said in a keynote address at *Trading Risk*'s New York *Rendez-Vous* in October.

He cited the overall insurance industry's lower return base relative to historic catastrophe yields as one reason for the challenge to InsurTech disruptors.

But there remain various areas of opportunity for ILS managers to invest in or partner with InsurTech ventures, he continued.

This includes reinsuring InsurTech carriers, investing in tech-assisted infrastructure to make the value chain more efficient and providing venture and growth capital to start-ups.

Venture capital investments may be outside the usual remit of ILS managers, but Jones suggested that ownership stakes could be seen by managers as just another source of delivering access to risk, with an equity holding comparable to having a quota share reinsurance partnership, though with operating risk.

Operational efficiency is another significant area for InsurTech but is "a much harder nut to crack", in part because it must be sold to large companies where it takes time to do proof of concept and for solutions to be introduced and fully implemented around the world.

The US flood insurance market's need for ILS capacity was also discussed at the conference.

"There's clearly a role for the deep pockets of the ILS market to step in," said Fermat Capital's director of new markets Joanna Syroka.

In the short term, it may be more likely that the National Flood Insurance Program is a source of business for the ILS market, rather than the private insurance segment, she said.

But panellist Ian Hanson, a vice president at Willis Re, said that as primary insurers developed more confidence in taking flood risk, it was possible there would be more excess-of-loss placements that could go to ILS markets.

At present, all but two of the 25 carriers writing flood business in Florida transfer it via quota shares to the reinsurance market.

Reinsurers were currently driving pricing of flood risks while insurers were acting as the distribution networks, he said.

Similarly, many insurers of all-risk commercial policies simply limit their exposure by putting low sub-limits on flood cover, said RMS' head of model solutions Emily Grover-Kopec.

Models for flood risk are "playing catch-up" due to the difficulty in sourcing data on risks, as the market is less mature than for other property risks, she noted.

On the current trend for M&A in the insurance industry, Scor's Jones said insurer mergers were more of a concern to the reinsurance industry than the alignment of reinsurers and insurers.

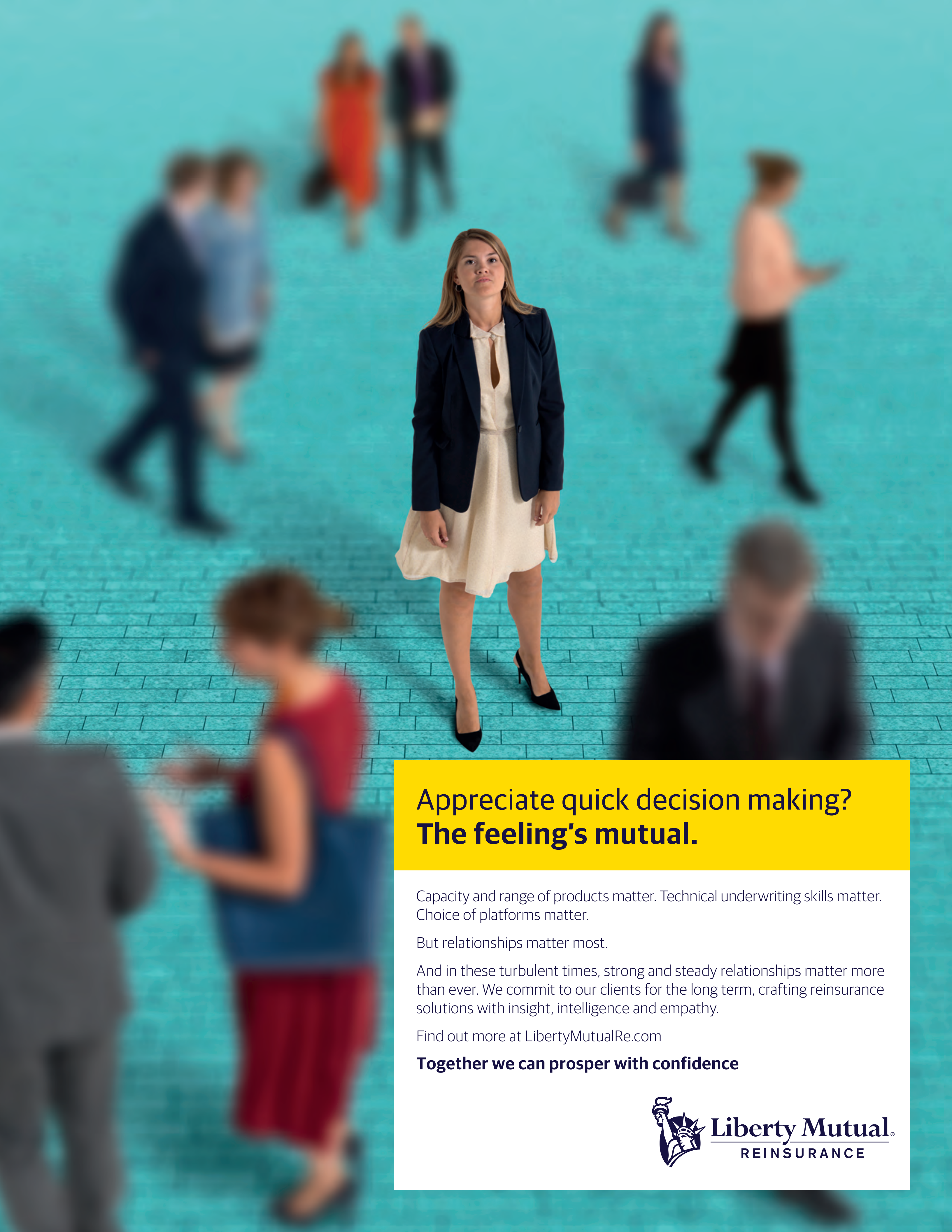
"When insurers and reinsurers merge we have not seen a substantial decrease in the amount of reinsurance that comes out of those companies, because when you put the two together you realise there is a lot of risk there," he said.

Early in the merger process, insurers merging with reinsurers will not want to be caught off-guard by carrying excess risk.

"There is a strong desire to take the risk directly from the consumer and right to the capital markets, which is a powerful idea," Jones noted.

But one challenge that insurers will face in transferring more risk to ILS investors is their exposure to non-peak risk, said Philipp Kusche, global head of ILS and capital solutions at TigerRisk Partners.

"Insurance companies don't just carry property risk, and so the education from investors about other risk classes has started a few years ago and is continuing," he said. "Building structures where other forms of risk can be shared with third-party investors is important."


Appreciate quick decision making?
The feeling's mutual.
Capacity and range of products matter. Technical underwriting skills matter. Choice of platforms matter.
But relationships matter most.
And in these turbulent times, strong and steady relationships matter more than ever. We commit to our clients for the long term, crafting reinsurance solutions with insight, intelligence and empathy.
Find out more at LibertyMutualRe.com
Together we can prosper with confidence
Liberty Mutual.
REINSURANCE

LGT: ILS investors expecting firm rate environment

How did your funds fare in 2017, and more importantly, how did your investors respond to the 2017 catastrophe activity?
The 2017 cat events have indeed had a negative impact on our portfolios as a number of our US-focused reinsurance transactions were affected, mainly due to hurricanes Harvey and Irma and the wildfires in California. In addition, the higher frequency of attritional losses from tornado and hail events in the US contributed to the loss burden.

At LGT ILS, we focus on the segment where additional reinsurance capacity is truly required – natural catastrophe risks in peak zones – and given that we write a globally diversified book, the losses were still very much in line with expectations considering the significant event activity. The overall impact to our funds from the 2017 cat events was limited to single-digit drawdowns for our higher-risk strategies while our more conservative funds were even able to generate a positive – albeit lower than normal – return for the year.

As such, the 2017 events and the corresponding impact to our funds did not come as a surprise to our investors; if anything, we actually received a series of inquiries asking if they should increase their allocation, under expectation that such loss events may also generate opportunities in the market.

And who are the investors ultimately backing your capacity?
Our investor base consists of institutional investors such as pension schemes, family offices and sovereign wealth funds – all professional investors with a profound understanding of the asset class and long-term investment horizon. Many of our investors have been investing in ILS for over a decade now. Our investors allocate only a small share of their portfolios to ILS in order to benefit from the diversification effects and low correlation of returns to their other financial market investments.

We understand you have recently established a rated reinsurance carrier in Bermuda by the name of Lumen Re – can you give us some more background on this? What is the business rationale behind Lumen Re?
Well, to be precise, Lumen Re was actually established back in 2012 under the name Collateralised Re. Since then, LGT ILS has transacted over $14bn in collateralized reinsurance limit on behalf of LGT ILS Funds and, in 2017, generated a premium income of $250mn. Over the years, LGT ILS has often faced cedants who wished to access capital markets capacity, but preferred rated paper to ease the transaction process. While the superior collateral security mitigates credit risk, the operational work and additional administration has increasingly been deemed cumbersome.

Furthermore, engaging with a rated reinsurance carrier to act as fronter has more and more come under scrutiny as the addition of a third party complicates negotiations, with many cedants also being wary of concentration risk with one reinsurer.

> "At LGT ILS, we maintain a long-term approach and look forward to supporting our reinsurance partners in 2019 and in future years to come"

Hence, in order to extend our reinsurance offering to cedants requiring rated paper, LGT ILS injected significant equity capital in 2017 and has rebranded Collateralised Re to Lumen Re. Lumen Re continues to act as collateralized carrier for the LGT ILS Funds – yet, rather than setting up individual trusts for each counterparty and transaction, capital is retained within Lumen Re and assets are invested in short-term government paper, thus mitigating any potential financial market risk.

The intention of Lumen Re is not to run leverage in the reinsurance sense; all first-event limits remain fully collateralized. The benefits are clear: cedants who do not wish to manage the collateral process now simply face Lumen Re as a rated reinsurer. Capacity remains collateralized behind the scenes, providing cedants with superior security, probably the highest available in the entire industry. No leverage, no credit or financial market risk – the perfect reinsurance carrier. AM Best has assigned the vehicle a credit rating of A/Excellent.

As a last question, what are your expectations with regard to reinsurance premium levels for 2019?
Not only are reinsurers still absorbing losses from the 2017 cat events, but we have also seen some significant loss activity in 2018. Most notably, the US has seen two recent hurricane events with Florence and Michael, and there has been continued wildfire activity in California. In addition, the typhoons and flooding in Japan as well as other small cat events in Asia are swiftly eroding the earnings of many reinsurers and negatively impacting their profits for 2018. Several US primary insurers and numerous reinsurers are facing the second consecutive year with a negative technical result. Yet, at the same time, the global reinsurance market has sufficient capital available to both pay for the most recent loss events and to supply fresh capacity for new protection purchases in 2019.

Likewise, we continue to see firm interest from our investors despite the latest cat events. Market feedback indicates that such interest has further increased as investors hope for a stabilization and potentially even an uptick in reinsurance premium rates. We expect a firm rate environment for 2019 as reinsurers will demand premium increases for loss-affected programs, especially those with exposure concentrations in Florida and the southeast US. Such "payback" elements support the partnership approach in risk sharing. Considering that we still have some of the North Atlantic hurricane and the Pacific typhoon season and a full European wind season ahead of us to add to the annual loss burden prior to the January renewals, we anticipate a stable premium environment at the next renewal round, and possible increases for loss-affected programs. At LGT ILS, we maintain a long-term approach and look forward to supporting our reinsurance partners in 2019 and in future years to come.

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

Market dynamics: challenges and opportunities

PartnerRe's Dick Sanford on the state of the reinsurance market

Given this year has been benign in terms of catastrophe losses, what rate movement do you expect at the upcoming January renewals?

It's difficult to predict where rates will be at January renewals but looking at the market, we have noted some meaningful retrenchment by underwriters on habitational risks, with capacity being reined in and risks being non-renewed in the standard market. But more broadly, especially with respect to catastrophe risks, rate levels did not hold after 1 January 2018. Customers with renewals at 1 January did get rate increases immediately following Harvey, Irma and Maria losses, but by mid-year, the market had changed and alternative capital providers fully reloaded, creating a supply glut.

What are the competitive advantages of a privately owned versus a public reinsurance model in the current market environment?

Clearly, long-term committed capital under private ownership affords several advantages. From a customer-focus perspective, privately owned reinsurers have the flexibility to engage with their clients on a less transactional and more holistic basis. They are able to consider the needs and long-term goals of their insurance clients and enter into relationships that will help them achieve their goals. Clearly this is not an approach that works for every client, but for clients who value long-term partnerships, willingness and ability to pay claims, as well as unquestioned financial security, private ownership is the obvious choice. PartnerRe has the added advantage of being both privately owned and a pure-play reinsurer, which means we do not compete with our clients, either for their business or for their talent, and we are a trusted discussion partner when developing new products and innovative approaches.

Do you expect more M&A in the reinsurance industry? Do you think takeout multiples will continue at similar levels?

Consolidation is likely to continue, at least at its current pace, for the foreseeable future. Our industry suffers from an expense problem and many view achieving scale as the best way to drive greater efficiency. Fortunately, PartnerRe has already been through this phase and has emerged as a stronger, pure-play, privately held reinsurer with an owner that accepts that assuming volatility is inherent in our customers' business and is central to our value proposition. Because of this, PartnerRe is uniquely positioned to benefit from the current M&A trend.

> "From a customer-focus perspective, privately owned reinsurers have the flexibility to engage with their clients on a less transactional and more holistic basis"

The takeout multiples we're currently seeing in the market appear somewhat heady to me. This is likely a function of supply and demand. As more companies strive to achieve critical mass to remain relevant and realize expense efficiencies, there are fewer and fewer attractive opportunities available on the market. Nonetheless, there is no shortage of capital and absent attractive returns in the core business of assuming risk, executive management and boards will feel increasing pressure to "do something", thus fueling the M&A trend.

How does broker consolidation affect the reinsurance industry?

Broker consolidation is a net negative for the reinsurance industry. First, it means fewer choices for cedants, with many concerned about being assimilated into one of the larger brokerages and fearful of being lost in the machine. Second, as the largest brokers gain more market share, reinsurers lose some of their negotiating leverage, especially the smaller and specialist reinsurers that have fewer places from which to source business.

Ultimately this consolidation makes it more difficult for the smaller brokers to compete against the array of services provided by the largest brokerages. There is a human element to this as well – consolidation rarely occurs without some rationalization of resources and the result will be fewer people needed in our industry.

Is the traditional reinsurer becoming more adaptable to technological change and innovation?

Traditional reinsurers, and insurers for that matter, are slow to adapt to technological change and innovation. Structurally, the heavy burden of legacy systems and the cost associated with rapid evolution have proven to be large hurdles. Many reinsurers have taken a "jump on the bandwagon" approach to this problem through a wide variety of InsurTech investments that they hope will one day bear fruit.

At PartnerRe, we have taken a more deliberate approach and seek to work with our clients and other innovators who present unique approaches that employ technology to produce better outcomes for risk takers. We stand ready to put risk capital to work in support of those efforts as a reinsurer.

What did the reinsurance market learn from 2017 that it didn't know before?

Last year settled the question once and for all that alternative capital is now a permanent aspect of the market. It will likely remain focused on short-tail business lines as investors continue to seek liquidity over a measurable time horizon. For reinsurers, the most viable strategy is to assume that alternative capital is here to stay and to find ways to co-exist with it in an intelligent way.

Dick Sanford
Head of North America P&C,
President of PartnerRe US

Strengthening tomorrow

Recent events have confirmed, now more than ever, the need for resilience. Resilience in our balance sheet. Resilience in our relationships and commitments. Resilience in the models that help us construct a clearer picture of the future. Resilience for today and the many tomorrows to come.

How do you spell tomorrow? **TMR.**

Lumen Re

Rated A/Excellent by A.M. Best

Lumen Re Ltd (Bermuda) is sponsored by LGT ILS Partners
info@lumenre.bm

LGT ILS Partners
lgt.ils@lgt.com