

# PErspective in INSURANCE

A FEATURE EXAMINING THE ROLE OF PRIVATE EQUITY IN THE INSURANCE INDUSTRY

## How is the market for cat bonds and insurance-linked securities?



The market for cat bonds and insurance-linked securities (ILS) has revolutionized the reinsurance industry in recent years, with

insurers increasingly turning to the capital markets to transfer peak risk, instead of to the traditional reinsurance companies such as Munich Re and Swiss Re.

On the other side of the market, alternative investors – private equity, hedge funds and, more recently, pension funds – are increasingly comfortable with cat bonds and ILS, which have produced annualized returns of more than 8 percent over the last 12 years, the Financial Times reports. Since their performance is not linked to that of other assets, they are an attractive option for investors looking to diversify their risks.

The outstanding cat bond and ILS market reached an all time high of over \$23 billion in 2014, and the outlook is strong for 2015, according to niche news source Artemis, which specializes in the space. A BNY Mellon report from the end of last year predicted that the cat bond market would reach \$50 billion by 2018.

Traditional reinsurance companies have been hit hard by the new reinsurance model. In recent years, alternative capital – supported by low interest rates – has flooded into ILS and cat bonds, driving down prices in the traditional reinsurance world. Ratings agencies have taken a bearish stance toward the reinsurance sector as a whole, with Moody's Investors Service (Moody's) downgrading the sector's outlook from "stable" to "negative" in June. Moody's expects catastrophic reinsurance prices to drop 10 to 15 percent in 2015.

Fears over the arrival of "fast" money seem to have been somewhat overstated. Artemis notes that capital from maturing bonds is continuing to be reinvested in the industry, along with new inflows from other sources. However, a Moody's research report released in September stated that interest rate rises, even small ones, have caused some funds to pull back due to inadequate returns. The report also points out that the reliability of the alternative capital model has yet to be tested by a major U.S. catastrophic event.

Nonetheless, the cat bond market looks set to continue to grow. Michael Millette, partner and managing director at Goldman Sachs said in an interview with [insurancelinked.com](http://insurancelinked.com), "There are many elements of traditional reinsurance that are useful and convenient and the very best reinsurance programs will feature a mixture of the two." Most commonly, programs will have a ratio of 70 percent traditional reinsurance, 30 percent cat bonds, although some may go up to a 50:50 ratio, he said.

Brokers will increasingly be called upon to offer cat bonds and other ILS to their investment clients, as what was once an extremely boutique product becomes more accepted in the investing world, according to Artemis. For example, London-based insurance and reinsurance brokerage Alwen Hough Johnson recently gained authorization from the U.K.'s Financial Conduct Authority (FCA) approval to launch a new capital markets broking unit AHJ Capital Markets Ltd, specializing in ILS and cat bonds.



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