ILS NEW YORK 2019

UNLOCKING THE NEXT PHASE OF ILS GROWTH

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Post-event Report

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INTRODUCTION

Welcome to the Artemis ILS New York 2019 conference report, which provides insight into some of the debates that took place between speakers and attendees during Artemis' third event in the region.

The conference was held in New York City, in midtown Manhattan with some 350 delegates attending the event, and a waiting list for spaces that exceeded 70 by the day of the conference.

Attendees were treated to insightful and thought-provoking discussions from industry professionals about the current state of ILS and what the future holds for the market.

Held in early February 2019, the event brought together experts from across the world to reflect on what has been a testing period for the ILS market, following two consecutive years of large loss experiences.

This year's panels focused in particular on how ILS can be integrated further into the traditional re/insurance business model, the potential for technology to act as a driver of ILS market growth, the need for efficiency in the value chain and the importance of origination, as well as on future opportunities in the public risk transfer space.

Speakers also shared their experiences of how investors have responded to recent losses, and suggested some ways that the ILS market can learn from the past two years and improve its practices to be more resilient and better prepared for the future, ultimately encouraging more transfer of risk to the capital markets.

Artemis ILS New York will be back in February 2020. We hope to see you there!

Our next conference will be held in Singapore on 11th July 2019, tickets are available at www.artemis.bm/ils-asia-2019

Steve Evans
Founder & Editor, Artemis.bm

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The first session of the day focused on the next phase of growth for the ILS market and the integration of third-party capital into the traditional reinsurance business model. It was led by Judith Klugman, Co-Head of ILS at Swiss Re Capital Markets, who began the discussion by questioning whether the role of traditional reinsurance was changing in response to the growth of ILS.

Klugman noted that reinsurers have traditionally just been aggregators of risk, but asked the panellists whether they had noticed a shift towards becoming distributors of risk.

“To some extent we will always be holders of risk,” said Aditya Dutt, President of Renaissance Underwriting Managers. “And you can say you’ll hold it against public capital or you’ll hold it against partner capital or whatever you want,” he added. “But I’m not sure we’ll completely move into the moving business, I think we’ll always be somewhat in the storage business.”

Dutt explained that, for RenRe, the shift towards growing a larger third-party capital platform has been a client-driven need. “To us it should always be born out of a client need,” he said, “otherwise it’s not durable.”

Lorenzo Volpi, Managing Partner at Leadenhall Capital, agreed that reinsurers should be constantly looking to evolve and find the right “strategic fit” for the needs of their clients.

However, he argued that the dynamic should be a two-way relationship. “You have the clients who should trust the fact that you are a centre of excellence for ideas in insurance, and you have a duty to constantly stay in touch with them and provide them with an understanding of what has happened in the property cat market over the last three years,” he said.

Next, the panel turned to the catastrophe losses of the last two years and the impact of third-party capital on the traditional reinsurance pricing cycle.

"I'm of the firm belief that the cycle is going to be a much shorter cycle going forward, and that we will always have opportunistic investors who are ready to jump in," said Klugman. "But now, with the events of 2018, how do those end investors feel about the performance of the past two years?"

"Now is not really the moment to just push and try to raise a lot of capital or tell everyone they should jump on the asset class," Volpi remarked. "It's probably more important to make sure that the investor community understands our asset class as much as possible and that we keep building this trust and this relationship because this is a long-term play."

Volpi explained that Leadenhall's investors had generally proved to be sticky and understood the long-terms benefits and diversification of the ILS class. "The main volatility we've seen is only linked to the high net worth individuals, so the wealth money managers or the family offices," said Volpi. "Those guys that always have this mindset of being opportunistic."

Another factor in the catastrophe losses from 2017 and 2018 has been the unprecedented levels of loss creep stemming from events such as Hurricane Irma, which has resulted in issues of trapped collateral for many ILS investors.

Klugman asked the panellists whether they were anticipating any problems with providing fresh capital, noting that funds would require clients not only to remain sticky, but to double down on their investments.

"Like everybody else, we have seen a lot of development on Irma beyond what we expected and beyond what the models predicted," said John Forney, President & CEO of United Insurance Holdings.

"We have released collateral with a bunch of our partners, and there were times when we had to call them and say we're sorry but the losses have continued to develop, we need that money back," he continued. "And every single time within four days we had the money back and we were able to pay losses.

Aditya Dutt –
"It was a tough year and there's no mincing words about that."

"So for us, the collateralised structure is great and our partners have proven that a contract is a contract and if there are legitimate losses then even after the collateral has been released, that money is going to come back and we are going to be able to pay losses. So, to me, our reinsurance partners in the ILS world have performed brilliantly in the face of really what was very unexpected occurrences, and different to what they told their investors to expect."

"The bottom line is it was a difficult year," added Dutt. "But I think again if you communicate difficult things to people that you have some kind of trust, faith, longevity of relationship with, I think things generally work out. But it was a tough year and there's no mincing words about that."

Addressing concerns about pricing, Kathleen Reardon, CEO of Hamilton Re, commented: "At 1/1 there was a little bit of flock to quality, we did see some of that. But the other thing here is we've had a lot of loss examples to learn from, and I think Florida – and as you mentioned Irma – is the perfect petri dish for this to work."

"If we keep demonstrating that we are deploying our partner capital reasonably, getting expected returns that are comparable to the risks they're taking, they will come back," she stated.

Opening the floor up to audience questions, conference attendees were eager to pick the experts' brains on whether they could see the ILS space expanding beyond natural catastrophe risks in future to include new perils, such as cyber.

In response, Klugman highlighted the unique dependency of the ILS asset class on third-party risk assessment, which is restricting investment for new perils. "You can't price something if you don't know how much risk you're taking," she noted. "So until there's a robustness around the modelling and assessment of how much risk you're taking, that is what's gating this moving forward."

Volpi added that, as stewards of investors' capital, it is more prudent for ILS managers to remain cautious and allow the traditional reinsurance space to fully explore and model a new area before seeking opportunities there themselves. "We don't really want to enter too much uncharted territory at the cost of our investors," he warned.

"If we go back to what Lloyd's is really good at – and Bermuda – it's getting those new risks and figuring them out without the track record," said Reardon. "But I think once that next line of business gets to that similar packaged up type of scenario, I think it would be very attractive to the next investor community."

The day's second panel explored the potential for technology to drive growth in the ILS market. Tom Johansmeyer, Co-Head of PCS Strategy and Development at Verisk Insurance Solutions, chaired the discussion and began by asking participants to identify the fundamental problems that technology needs to solve.

Neil Isford, EVP of Sales and Client Development at RMS, took up the question from a risk modelling perspective, suggesting that advances in computing power could potentially streamline the modelling process and enable real-time data gathering.

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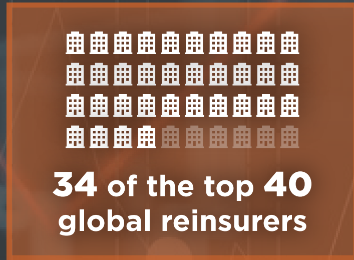

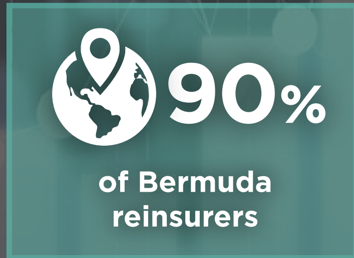

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"In my view the big opportunity here as we start to get into elastic computing and high definition models, you start to get to a point where you have near real-time ability to get information back, instead of overnight runs," he said. "Because in the end it's about getting better information more quickly to make better investment decisions.

Andries Hoekema, Global Head of Insurance at HSBC Global Asset Management, noted that technology could also provide avenues for ILS into emerging markets such as Asia, where HSBC sees "latent potential" for insurance products that haven't yet found their growth, including on the investment side.

"The technology that I'm hoping you guys can all deliver would essentially revolve around making this a more attractive product," he said, "and that possibly means the dreaded term that we call a slight compression of the value chain."

"We think there is massive opportunity for technology today that can be used tomorrow to improve both risk pricing and the allocation of that risk for certain classes," added Sean Bourgeois, CEO of Tremor Technologies Inc.

Bourgeois stressed the importance of tackling operational efficiencies in the value chain, helping risk move from one side of the market to the other based on supply/demand economics.

This could involve the introduction of further "programmatic trading with auction technology at the core," he explained, which is today "intermediated in a much slower, and more expensive and time-consuming way, with price discovery that is sub optimal."

Yaniv Bertele, Co-Founder & CEO of Vesttoo, a digital marketplace for structuring, issuing, and trading insurance assets, agreed with Bourgeois, pointing to the potential cost savings in simplifying the bidding and auction process, as well as reducing the paperwork required to structure ILS deals.

"Taking those and digitalising the entire legal framework, streamlining the data, and providing insights to the structure that could dramatically reduce the cost of capital," said Bertele. "This is where we are focused."

Neil Isford –
"In the end it's about getting better information more quickly to make better investment decisions."

Picking up on the thread of efficiency and data, Johansmeyer next turned the discussion towards the issue of transparency and whether the insights gained from sharing information are always worth the downsides.

"One of the difficulties in really expanding the investor base for this asset class is the fact that it's difficult to get data to include the asset class in traditional asset allocation models, said Hoekema.

"Everybody seems to be building up their own kind of thing, and then guarding it," he continued. "I think a little bit more sharing of data and models will lead to this market exploding as far as I'm concerned. There is so much more capital available and I think there is so much more risk in the world that can be insured."

"It's not just to be able to model better risks," Isford concurred, "but it's around all these inefficiencies that go with data integration, data collection and data aggregation."

Overcoming the barriers to data aggregation will fall partly to the industry and partly to government and regulations related to data sharing and privacy, he added, recommending that both sides take steps to work in parallel.

"I don't think there's really a big transparency problem right now," countered Bourgeois.

He predicted that, over time, technology will mean risks can be unbundled from large groups, allowing investors to focus in on exactly what they want. "That's a great end state and that's where technology can be super powerful," he told the panel.

However, Johansmeyer queried whether such an increase in granular risk trading would result in desirable pricing optimisation, as parties on both sides of the deal try to zero in on the risk.

"You're absolutely right but to me this creates places to get out of and places to get into," said Isford.

Andries Hoekema – **"A little bit more sharing of data and models will lead to this market exploding."**

"Some [clients] want to get out, some see this as an opportunity," he explained. "If they've got better granular better than their competitors then they can be more prescriptive … I think using tools, using technology, the early adopters will find opportunities here for returns and they will be ahead."

The panel went on to highlight the importance of neutral players, such as modellers and rating agencies, in further integrating technology into the re/insurance business model.

"I think they are key," said Hoekema. "Really there are ways to share data that are mutually beneficial for everybody, and investors are able to just continue to take their view, take their underwriting process and compare that to where the market is in overall terms.

"And the other component to that of course is the rating agencies," he continued. "In the corporate world there is a role for them and I think maybe for rating agencies there is a big role in this space as well."

Towards the end of the discussion, an audience member returned to the topic of granularity, raising concerns that the insights and 'unbundling' of risk enabled by technology could lead to a cherry-picking scenario in which some risks become uninsurable.

"Broadly I would say unbundling risks and pricing them properly individually is exactly what you want to do," contended Bourgeois. "There should be a price for every risk."

"What the cost is at the primary level all the way through to the capital, if you make that more efficient then that's better," he said. "But I don't think that's something to fear."

Hoekema also weighed in on the issue: "If you're an insurance company you are managing risk correlation, and the more granular it is, the easier it becomes to manage risk correlation."

"To the extent that risks become uninsurable, you can get the government or some other entity of that type to step in and take over a component of the market that has a social utility that isn't recognised by the insurance companies," he suggested. "So I'm all for it, basically. The more granular the better."

After a short coffee and networking break, event attendees heard ILS experts engage in a debate about shortening the value chain and the importance of origination. The session was led by Cory Anger, Global Head of ILS Origination & Structuring at GC Securities, who kicked things off by asking the participants to define what the issue meant to them.

"We think of it less as taking out links of the chain or jumping links of the chain and more about making the value chain more efficient," said Ben Sloop, Chief Operating Officer at AmWINS Group.

"When you think about the new world and how capital is approaching risk differently, we think about it more as making sure each participant in the value chain is adding value and is doing what they do best," he explained.

Also on the panel was Frank Majors, Co-Founder of Nephila Capital, who contested the terminology that has come to characterise this issue. "I challenge the concept of a value chain and talk about a value ecosystem," he told Anger.

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"I don't think the over-simplified narrative of 'a chain is going to get removed' is necessarily the right way to think about it," Majors continued. "I think that there will be certain situations where that risk and capital gets together in this way because that's the most efficient way, and then another time it might go another way."

"When I look around at the fellow panellists, all of you disintermediate Nephila at some point and all of you trade with Nephila at some point," he said. "And we accept that and understand that. Our job is to add value, and sometimes we should be in that chain and sometimes we shouldn't."

Representing the end-investor perspective, Jeroen Bogers, Team Lead at Aegon Insurance Linked Securities, explained that, for him, compressing the value chain meant getting as close as possible to the risk.

"The main reason for this is because we want to understand the risk," he said. "And that doesn't mean that we do not invest in the fund. We invest in the fund because they can explain to us what they are doing, but we also want to invest directly with an insurer or reinsurer because they can explain to us what they're doing … So I wouldn't say we remove anything from the value chain."

The experts agreed that now more than ever it was essential for each company to define its position in the value chain, as technology and the growth of the ILS market begin to call into question traditional roles.

"We've had a certain amount of confusion even internally about what's our role," admitted Majors. "We find ourselves at all parts of the ecosystem, and that's fun. The reason for that is our investors at the end of the day probably don't really care about the structure, they want access to a risk premium that – in our case – catastrophe risk represents. And they just want to get that capital to that risk in the place where it gets paid the most. It's pretty simple."

Sloop added that the issue was particularly pertinent for AmWINS, who, as a wholesale broker, is often told that it is at risk of disintermediation.

"First and foremost we are a source of distribution, but we're now doing many of the functions I think that might have sat on the other side of the balance sheet," said Sloop.

Frank Majors – **"Our job is to add value, and sometimes we should be in that chain and sometimes we shouldn't."**

"In particular, we've dramatically expanded our ability across risk level underwriting and across portfolio management, and we're also continuing to expand in terms of claims management and handling the claims process.

"So ultimately we see an increasing appetite on behalf of reinsurers and the capital markets to find the leanest, most efficient way to tap into pools of risk."

Anger observed that, historically, attempts to shorten the value chain have been focused on portfolio structures rather than individual risk structures. She asked the panellists whether they felt that this approach would continue to offer the best opportunities for growth going forward, or whether a portfolio aggregation approach could be more valuable.

"For us it's if we can model it and if it fits the portfolio, we'd love to have it – if it has a good return," said Bogers. "So if it's a single risk transfer it doesn't have all the different things in there. If suddenly instead of property it's suddenly liability then we can do that. But the question is are there still those risk structures out there that are so easily modellable?"

Melissa Ford, Senior Vice President for the International Department at Everest Re, also offered some thoughts: "I can see that taking off a little bit but more for portfolios of single risks or a group of fac risks, or if the risk is of adequate scale," she said.

"My feeling is that buyers still want a traditional product that insurers and reinsurers sell, they just want it the most efficiently and as cheap as possible," Ford continued. "But if the size of the risk can justify the cost of some sort of ILS construct and offer savings at the same time, then we really don't think it matters whether it's single or portfolio. It shouldn't really make a difference in my opinion."

Ford also argued that the notion of compressing the value chain to create efficiencies and opportunities for growth is largely an issue that is unique to the U.S market. In regions with less mature markets, she suggested, more traditional operating structures are likely to dominate for some time.

"I don't think we're at a place right now where we're ready for that yet," she said, referring to the emerging markets Everest is active in. "The way I see it – maybe it's a little pessimistic – but as far as emerging markets go, and even I would say with Europe to a great degree, I see that basic traditional reinsurance is essentially going to be the way insurance is done for the next twenty to thirty years. I don't see that changing"

Melissa Ford –
"As far as emerging markets go … basic traditional reinsurance is essentially going to be the way insurance is done for the next twenty to thirty years."

Anger wrapped up the discussion by asking the experts to predict how alternative capital is likely to shape the value chain over the next 25 years, and to identify how they thought investors would like to see it change.

In response, Majors revisited a topic broached by the previous panel, stressing the potential in unbundling large groups of risk. "That makes sense and that's a win for everybody because somebody's peak becomes somebody else's diversifier. And so every risk finds its right home," he said.

"The more we can fine tune those price signals, the better for everybody – including society," he added. "Because if the price signal is that you're building on a flood zone, society is bearing that cost right now … So I think the industry can really serve a really valuable function. Bring down premiums where appropriate, increase premiums where appropriate."

"I absolutely agree that as the market matures increasing liquidity is going to be key," offered Sloop. "One of the big impediments to this historically has been a lack of real-time transparency in the portfolios … So ultimately where we see the world going, the more that you can have real-time access to good information, the more investors will be comfortable trading that in a more liquid fashion."

The audience returned to the conference room after lunch to listen to a new panel debate public risk transfer opportunities and issues related to the global protection gap. Joanna Syroka, Director of New Markets at Fermat Capital Management, began the dialogue by focusing on sovereign risk transfer.

"For countries that are looking at any sort of risk transfer – forget cat bonds versus insurance – any risk transfer for the first time it can be a daunting proposition," said Michael Bennett, Head of Derivatives & Structured Finance at the World Bank Treasury.

"Ultimately what you're talking about with a risk transfer transaction for a government is the possibility they'll be making payments and getting nothing back, which politically can be quite frightening for people," he continued.

"So I would say there's a momentum that comes from doing more and more transactions that maybe creates a safety in numbers quality for countries … As we bring other countries to market I think that builds upon itself."

"I think there's an increasing recognition that, working with the private sector, solutions can be made for developing countries through that kind of closer partnership," said Alexander Milne, Head of Insurance, Capital Markets & Trade at the UK's Department for International Trade.

"We think helping other countries and governments and municipalities and city leaders to understand these products can then potentially help to drive new issuances," he added. "The cold political reality of some of these things is 'why would I want to spend money to benefit my successors in five years' time?' So there needs to be a kind of mindset shift there."

Adam Bornstein, Global Financial Innovation Specialist at the International Federation of the Red Cross, was also in attendance on the panel, representing the humanitarian aid side of the debate.

He detailed the Red Cross's motivation for beginning to move into the risk transfer and ILS space, which has already seen it explore global resilience projects such as a volcano catastrophe bond.

"At the end of the day it comes down to a funding issue, where last year there was like $27 billion in humanitarian aid through these normal routes. But that's still about almost an $11 billion shortfall of what was actually necessary," said Bornstein.

"To be adaptable and to be relevant in the world, where capital is needed, we have to think about doing things more intelligently and more effective and more efficiently," he explained. "You need to get the private sector involved, and the Red Cross itself has to wake up to that moment.

"If we don't actually have a commercial product to offer and make it commercially viable, then we're not going to be able to fund the gap, we're not going to be able to come to market with products, and it won't be sustainable."

One of the most high-profile examples of governments utilising private market risk transfer solutions recently is the U.S Federal Emergency Management Agency (FEMA), which completed a $500 million cat bond on behalf of the NFIP in 2018, and recently secured $1.32 billion of reinsurance at the 1/1 renewals.

Representing FEMA in the day's discussions was David Maurstad, Deputy Associate Administrator for Insurance and Mitigation at the Agency.

He explained to the panel why FEMA was interested in utilising the capital markets, and how this kind of risk transfer solution would play into its overall protection strategy going forward.

"Right now what I'm trying to get people to do is to understand what the art of the possible is and what it would take to get to what a true risk transfer, protect-the-treasury type program would look like," Maurstad said.

"And so clearly we went to the ILS market then when we had the opportunity, had a successful placement last year, and we look to have something happen again in this year," he stated. "We see that as an additional means by which to access capital and to access the type of protection that I believe we ultimately need if we really are interested in protecting the taxpayer."

However, Bennet rounded the discussion out by advising that, for the World Bank, some transactions will always be more suited to traditional re/insurance solutions due to the political realities for the governments it works with.

"Some of our governments are very worried about having a transaction where there's never a payment," Bennett said. "So some of the transactions we do, we set a very low attachment probability so that at least there will be some sort of payment likely during the course of the transaction.

"And that sort of transaction where potentially there's a very significant difference between attachment probability and overall expected loss, in our experience we've found it's better able to be handled by the reinsurance industry than by ILS investors."

To finish the day, conference attendees returned after another break to hear the thoughts of a final panel consisting of session leaders Judith Klugman, Tom Johansmeyer, Cory Anger and Joanna Syroka. The experts used the time to wrap up some of the conversations of the day and to express their views on what to look out for next in the evolution of ILS.

Addressing the catastrophe events of 2017 and 2018, Klugman said she was impressed with the resiliency of the ILS market and its ability to quickly raise fresh capital, despite the heightened level of losses and some cases of trapped collateral.

"I think that the transparency of the capital markets product actually holds up," she said. "We're actually quite optimistic for the future of the cat bond product versus the other ways one can access the risk in the alternative world. But we think that the market was very resilient, and we're optimistic for going through 2019."

Tom Johansmeyer –
"I think we need to be prepared to be surprised more … It's the unexpected stuff that seems to be cropping up more and more."

Anger agreed that the ILS market response had been positive, but noted that the re/insurance industry as whole will have to face some difficult questions concerning recent disaster events.

"It is a little bit soon for cedants to figure out how they're going to respond to the 2018 events, because the losses were really centralised from September to now," she remarked.

"And obviously a big topic is whether wildfire should move into its own category because we now see two years with a more significant severity component," Anger continued. "And I don't think the market – whether it's traditional or alternative – has figured out yet how they're going to view that risk."

"I think we need to be prepared to be surprised more," offered Johansmeyer. "It's the unexpected stuff that seems to be cropping up more and more."

"The world is a dynamic place, things go cold and go boom without sufficient warning or certainly beyond expectation," he added. "And I think if we're going to look at risk, we've got to keep in mind that there's more to life than tropical cyclone and California quake."

"Sadly these are heartbreaking disasters all around but they are learning experiences," said Syroka, asserting that the catastrophes represent an opportunity for the industry to review its practices and grow.

"They're learning experiences from a modelling point of view and to start thinking from a regulatory point of view in terms of ways in which this type of risk can be quantified and managed," she said. "In the long run it's sadly a thing that will lead to more risk transfer and better risk preparedness and mitigation."

One of the recurring themes of the day was transparency, and Klugman once again picked up on the need for more openness and access to information in response to the disasters.

"One thing that I would say is that investors should demand of their dealers certain minimum standards in terms of the frequency of the loss reports," Klugman suggested, arguing that the industry should try to standardise its reporting where possible. "And the more transparency the better," she added, "but it should only be on the basis that you're actually giving out good information."

"These have been challenging years for the market, but investors bring a sort of independent different view on all these questions, which is only a good thing," added Syroka. "It means standards will improve, standardisation will improve. The right questions get asked and good practices get rewarded. That's good, that will make this market more resilient."

At this point in the session, a question from the audience contended that one of the larger underlying issues to the market's performance over the previous two years is the impact of climate change.

They inquired whether the experts were concerned that investors would abandon the asset class if it becomes a widespread perception that the frequency and severity of catastrophe events has permanently increased.

"I think that fundamentally the question that we have is: Is this the new normal? What we've seen over the past two years," said Klugman. "Or is this really just what the models would have predicted these past few years. And I think from our perspective the jury is still out."

"It's a complex risk and there's many other things driving these losses," Syroka countered. "It's not necessarily the climate risk or the hazard that's changing, it's that you've got more people living in areas that are being impacted."

"And so it's really easy to say climate change … but there's many underlying drivers that we have to be aware of and we have to stress."

One of the final issues explored during the session was the increase in the use of parametrics and whether they should be viewed as a replacement to traditional insurance or as a supplement.

"I think it depends on the client," said Anger "I think when we're talking parametrics, I've had some where they've said 'nope, this is the way I'm not going to buy from the traditional because the traditional wasn't giving me the credits that I should've gotten.' In other cases it is complementary, and I don't think there's a right way and a wrong way."

"I've seen it more as a complement for when have has been those capacity shortfalls," argued Klugman. "But really the key is understanding what are you actually trying to protect and creating a structure in terms of whether its parametric or whatever that trigger is, is that that client fully appreciates when that will be triggered, and is that solving their problem, and that they understand that basis risk."

Closing the debate, Johansmeyer pointed to the potential for parametrics to be used in covering emerging risks like cyber or terrorism, where the granularity of the triggers and the advantage of the quick pay-outs can potentially be most beneficial.

"If you've got a high velocity parametric cyber product that can deliver the 50, 60, 100 million dollars that you need at the time of crisis, or close to the time of crisis, that makes a serious difference," he said. "That solves problems, that's taking your client's need right to them. That's the sort of thing I'd love to see parametrics explore more."

To all our attendees, thank you for joining us, we hope you enjoyed the day and will attend again next year in February for ILS New York 2020.

To all our speakers, thank you for traveling so far to participate, for providing insightful and thought-provoking discussions and for engaging positively with event attendees.

Finally, we'd like to thank our kind sponsors of the event, without whom the day would not have been possible.

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$200 million

Cal Phoenix Re Ltd. (Series 2018 – 1) cat bond for California wildfires. GC Securities, structuring agent and bookrunner.

$250 million

Bowline Re Ltd. (Series 2018 – 1) cat bond for N. American earthquakes and storms. Aon Securities, agent and bookrunner.

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