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ILS Bermuda Executive Roundtable 2020

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FOREWORD

Welcome to Artemis' fifth Bermuda-focused ILS executive roundtable, which owing to restrictions caused by the ongoing Covid-19 pandemic, was held virtually.

In response to the global spread of the novel coronavirus, Bermuda, like much of the world, entered into an unprecedented period of lockdown as its government enforced restrictions aimed to mitigate the outbreak.

Against this backdrop, experts and leaders from across the ILS and reinsurance space began by offering some insight into how the Bermuda marketplace has responded to ensure continuity for clients both during the current crisis, and post-pandemic.

Participants agreed that to maintain robust investor and cedant interest at this time, transparency and clarity are key, and while some have undoubtedly been bruised by the recent loss experience, the future opportunity is ample and should attract both new and returning market players.

The potential for the emergence of new ILS start-ups was also debated. Some participants agreed that conditions in the Bermuda marketplace are ripe for new entrants, while others questioned exactly what these players might look like and what strategic advantage they might bring to the table.

Bermuda is known as a jurisdiction that stimulates innovation and participants suggested that the disruption caused by Covid-19 could accelerate and intensify the focus on technology.

The discussion also turned to the uncertain industry loss from the ongoing pandemic, and specifically the potential for a significant trapped collateral issue for the ILS sector.

Looking forward, roundtable participants offered their views on what Bermuda, its regulatory landscape and ILS community can do to ensure positive market momentum persists.

Steve Evans
Owner and Editor in Chief, Artemis

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PARTICIPANT INDEX

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Brad Adderley, Partner at Appleby, Bermuda

Sherman Taylor, Associate Director, Ocorian

Rick Pagnani, Executive Vice President, Head of ILS, PIMCO

Neville Ching, Managing Partner of Capsicum Re Bermuda, a Gallagher Company

Aaron Garcia, Portfolio Manager, Hiscox ILS

Dan Malloy, Chief Executive Officer, Third Point Re

Tom Johansmeyer, Head of PCS

Kathleen Reardon, Chief Executive Officer, Hamilton Re

Laura Taylor, President of Nephila Bermuda & Head of Portfolio Management

OCORIAN APPLEBY PCS

STEVE EVANS

To start, what are people's thoughts on how the Bermuda insurance-linked securities (ILS) and reinsurance market responded to ensure continuity for clients during the current crisis, and also post-pandemic?

BRAD ADDERLEY

I think the Bermuda market has responded really well, and I think we have seen ILS respond well. The BMA has been excellent, issuing electronic licenses and has been timely. There hasn't really been a time lag as a result of this new normal. A lot of us are having to learn how to deal with this on the fly and I would have thought there would have been more bumps in the road with people getting used to remote working.

From a Bermuda point of view, I've been very happy with it. I think the marketplace in Bermuda is vibrant. If it was vibrant before it is clearly vibrant now.

SHERMAN TAYLOR

Bermuda has a high penetration of internet and digital technology which helped insurers and service providers shift seamlessly to remote working when the pandemic threatened. This protected their business and employees. Business Continuity Plans have long been a feature of the policies and procedures of Bermuda companies; BCP's are revised and tested often and it is exactly an eventuality like COVID-19 that the BCP's are designed to protect against.

RICK PAGNANI

From an operational perspective, the ILS sector has always been keenly sensitive to business continuity and contingency planning. With this in mind, many managers were fully capable of carrying on all aspects of their business remotely without sacrificing the ability to professionally construct and service sound portfolios. The Bermudian market has been tested before by severe weather events, so we're familiar with the drill of reacting to non-standard working conditions.

Brad Adderley –
If it was vibrant before it is clearly vibrant now

Overall, the ILS sector has done well by its investors and their (re)insurance clients by providing well-priced capacity. Concerning the spectrum of outcomes, you saw instances where managers were unable to raise additional capacity with several experiencing net declines in AUM due to redemptions and further loss emergence from previous events. Trapped capital continues to hamper the sector – some more than others. Conversely, several managers were able to secure new funds and meet the increasing capacity demands of the market.

NEVILLE CHING

Most ILS fund managers who have been imbedded into the primary cat and retro markets for the past 10 years plus are seeking to protect core client relationships and have been prioritising available capacity at the key renewal junctures.

AARON GARCIA

In common with broader financial services industry and other office-based employers, ILS and reinsurance firms have transitioned to a work from home structure, which appears to be working well in that business has been successfully transacted through the major reinsurance renewal dates of April 1st and June 1st.

Within Hiscox, operations have run smoothly and the business has been able to function well. We are pleased with this outcome, and also mindful that if such an event had happened even just five years previously, the ability to transfer such a significant proportion of the global economy to a home-working environment would have been much diminished. Post-pandemic, we expect the working environment across our market to be different. While business-as-usual continuity is somewhat assured, we believe this event is forcing a cultural shift with respect to using technology and embracing more flexible working styles.

DAN MALLOY

Third Point Re has class knowledge of pandemic cover and are an innovative company in an innovative Bermuda market. Unsurprisingly demand has substantially increased, and on the traditional reinsurance side, we are prepared to provide cover for future communicable disease risk. For COVID-19, we are at the embryonic stages of developing new structures to give some kind of relief for COVID exposures – for example, helping clients manage and mitigate the economic impact of the epidemic on balance sheets and income statements. There is certainly interest from brokers and clients to talk about both approaches.

Dan Malloy

More generally, the wider reinsurance market still has no handle on what its total exposures are, and many companies are simply trying to manage the current situation and gauge the impact of economic shutdown on their books of business.

Plus, there are many underwriters and brokers who have never traded and worked in a hard market. At the moment it's all too common to hear people speak about the reinsurance and ILS markets in the third person – detaching themselves from the current situation. They are sitting back and waiting to see how 'the market' will respond or watching to see if rates will rise or not. But we are the market – the brokers, the underwriters, the actuaries. Nothing will happen – no mooted innovation, no new structures, no new deals, no rate increases – unless we, as a market, make it happen right now.

TOM JOHANSMEYER

I can't speak for what the market is doing, but I can certainly tell you what I'm seeing. PCS has had no trouble reaching, engaging with, and supporting our clients in the Bermuda market – as they support their clients worldwide. Absent our usual face-to-face meetings, we've done a bit more on the phone, videoconference, and other digital channels. And that's probably no different from what you're hearing from everyone else.

STEVE EVANS

ILS has faced some selling pressure; but appetite is still strong. With uncertainty over potential pandemic losses, what can the market do to ensure it maintains strong investor and cedant interest?

TOM JOHANSMEYER

The one thing everyone wants is clarity, but when you're in new territory, that's the last thing you're likely to find. For now, what's likely most important is that both cedants and markets continually survey the industry landscape, monitor the challenges we know about today, and identify the new ones that will inevitably pop up.

For cedants, it's probably just going to come down to capacity. The retro and ILW markets were already looking tight at the beginning of the year, before the pandemic even gained momentum. And there were rumblings of that extending to Japan and Florida well before their respective April and June reinsurance renewals. COVID-19 appears to have only served to tighten capacity availability a bit, so if the ILS market can deliver at manageable pricing and terms, then protection buyers should remain interested.

KATHLEEN REARDON

Pandemic risk can easily be carved out with appropriate wording. Appropriate contract definitions should be able to protect the investors from contagion and provide them with access to the risk and returns they desire. The challenge will be to retain the investors who experience losses from a risk they hadn't contemplated and that hadn't been priced for.

BRAD ADDERLEY

That to me is a flight to quality. No one knows 100% the loss of Covid-19. People have been throwing around the number $100 billion. Well, $100 billion means, will your reinsurers pay the claims, are they financially sound to pay the claims. If the Bermuda reinsurers pay their claims, and let's assume they do, then that means the cedents will have even more comfort in Bermuda, either with Bermuda reinsurers specifically or the Bermuda marketplace, or Bermuda regulation. Because, at any time you want them to pay, you're here to pay claims. That's only going to bolster Bermuda's reputation.

The truth of the matter is, people questioned whether or not there was going to be a traditional hard market again. Well it looks to me like it's a traditional hard market before the hurricane season even starts. And by the way, it's not going to get better, we are not suddenly going to find a magic bullet. If anything, there's going to be more court cases, there's going to be more losses, there's going to be more disruption. So, there's more bad news coming and there's more good news coming.

NEVILLE CHING

Some investors seeking clarity in the near term and those bruised from four years of loss activity may lose confidence in the system temporarily but we believe that the scale of the future opportunity will entice them back. Gold standard ILS managers are retaining investor confidence. It will likely be some time before the fog surrounding any entrapment of collateral affected by Covid-19 lifts but it is in everyone's interest to work towards positive solutions. Pandemic risk is proving to be one of the most correlated of 'risk classes' of all time and of course is the 'event' that was rarely considered historically. Traditional defined natural perils events will continue to produce non correlated returns and deliver diversity.

SHERMAN TAYLOR

A core value proposition for ILS is that the asset class is not directly corelated to equity markets. The equity market shocks that accompanied Covid-19 did not affect the ILS asset class. The ILS market needs to continue to contrast an investment in ILS versus traditional investments versus alternative investments. The ILS asset class occupies a niche space between traditional and alternative and this is how it should be sold to investors.

On the cedant side, COVID-19 has shown us that the ILS market can provide capital for perils like operational risks. Cedants should be very interested in the fact that the ILS market now covers a very wide and diverse range of perils.

RICK PAGNANI

From an investor perspective, we are at a critical juncture and I believe an emphasis needs to be placed on transparency and communication. Those of us in the industry need to clearly communicate how ILS fits into a well-balanced portfolio and establish appropriate expectations with investors up-front. We do a great job of highlighting the diversification benefits of the asset class but we tend to be less clear about some of the idiosyncrasies of the business (like loss development and scope of cover). I think some managers have paid dearly for not painstakingly educating their investors about the asset class and therefore fall short of expectations.

Rick Pagnani – **An emphasis needs to be placed on transparency and communication**

From a cedent/broker perspective I think consistency, predictability, and responsiveness is key. In general, selecting the right partners and establishing long-term trading relationships is critical. That being said, as portfolio managers, we won't always be able to deliver messages that our partners like to hear from either a pricing or capacity perspective. Delivery of these messages is more palatable if you clearly state the rationale behind your decision-making and are consistent with respect to the approach taken to reach such decisions.

DAN MALLOY

Business Interruption from commercial insurance will be a major exposure for the market. Fortunately, Third Point Re has minimal exposure to that potential loss. We will have losses, but they will be manageable – Covid-19 is not a capital event for us. Also, we have not relied on third party capital to manage the risk in our portfolio since we began writing cat.

More broadly speaking, we are part of a very dynamic market in Bermuda, with a healthy network of clients, brokers and reinsurers. If we look at the reinsurance market's reaction to historical major events, it has always resulted in an evolution in the way reinsurance is bought and sold. We are currently in the middle of one of those periods. Bermuda has built a reputation for innovation, blending new capacity, new ideas and new talent with traditional reinsurance. I believe we will emerge stronger from this crisis and remain a vital component of the global reinsurance market.

STEVE EVANS

How do you expect the Bermuda market will react to help investors and cedants at this time?

RICK PAGNANI

Like it always has with new capacity and new products. Bermuda's regulatory platform continues to foster judicious entrepreneurship and creativity - the exact ingredients necessary to meet these current challenges.

SHERMAN TAYLOR

The Bermuda market is resilient and that is exactly what is needed in a crisis such as Covid-19. Regulators, service providers, cedants and insurers in the Bermuda market adapted well to ensure continuity. Bermuda is important to the global (re) insurance industry which can now view the jurisdiction can be a safe harbor in times of crisis.

KATHLEEN REARDON

Bermuda has a long history of stepping up when the world faces catastrophe. It's what Bermuda was built for and this time will be no different. Supporting our cedants and balancing our commitment to investors and to clients has always been a central tenet of industry best practices. Bermuda will innovate, lead and continue to support the global re/insurance markets with capacity, price discovery and responsible risk taking.

TOM JOHANSMEYER

The first thing I noticed about the Bermuda market was the speed at which our community was able to adapt its operations to the pandemic environment, resulting in continued cedant and investor service with minimal disruption.

What I find more interesting is how the community down here is thinking ahead. I chose to set up shop in Bermuda specifically because of the support and collaboration that's possible down here. I used to joke that in other markets, the answer to most new ideas is "no," followed by a long period of slow, gradual, and partial adoption. In Bermuda, on the other hand, I used to say that the answer to a new idea would be "yes," "maybe, but not like that," or "hey, you're about halfway there, and we'll help you with the other half." The community down here is creative, moves quickly, and always looks for new and interesting ways to manage risk and capital more effectively.

At some point, we're going to have to shift our thinking from enduring pandemic market conditions to learning from them and executing on those lessons. The Bermuda market is already laying the groundwork for that transition.

Sherman Taylor –
The Bermuda market is resilient and that is exactly what is needed in a crisis

BRAD ADDERLEY

Cedents will feel helped by the fact that we're paying claims. But, at the same time, they are going to find that the reinsurers now, after the losses of the last few years, are going to demand more. I think the tail is now driving the dog. The pricing is going up and the terms are going to go up, and insurers are going to have to realise now that it is going to be a harder market for them.

So, we are going to help the cedants by making sure we drive better terms, we are also going to help them by paying claims, and we'll also help the cedents by providing more capital. Because at the end of the day, the prestigious ILS funds will raise capital, and the new ones on the go are not as small as they used to be.

AARON GARCIA

ILS Managers have the responsibility to help investors navigate through the uncertainty with transparent and clear communication, and ensuring that they are ready to capture the opportunities that will arise during this period of distress.

For cedants, in the face of price rises, clear guidance on capacity and coverage in as timely a fashion as possible will assist in navigating a hardening market. The reinsurance market has been accustomed to abundant capital for some years now, and for some market participants this is all that they have known. A historical perspective can be drawn upon from those market practitioners who have seen previous hard markets, not just within the underwriting community but also amongst intermediaries.

DAN MALLOY

Entrepreneurialism and innovation are part of Bermuda's DNA – the island has a history of responding quickly and efficiently to disasters. For example, a new breed of insurance and reinsurance companies set up as a direct response to Hurricane Andrew in 1992, and again in 2001 after 9/11 and in 2004 following Hurricanes Katrina, Rita and Wilma.

However, in this instance, I don't see a rush of startups in Bermuda. Setting up new companies in a lockdown world while an event is still occurring and unravelling would be tricky – and that's before taking into account the practical considerations of incorporating. It's more likely that some companies on the island will look to leverage existing management, underwriting talent and capital bases - possibly in the form of a sidecar. Either way, it will likely be another defining moment for the Bermuda market's history books.

STEVE EVANS

With capital key at this time for cedents, but investors more wary and traditional sources of capital also being more selective, could there be an opportunity for new ILS startups if they can find the backing?

KATHLEEN REARDON

Absolutely, I think the market is ripe for new entrants who bring a new approach to managing and deploying capital in insurance.

BRAD ADDERLEY

I think there's no question. If anything, it is getting stronger. I do think there's going to be a flight to quality, people are going to look at business reputations. And I wonder also, I don't think it's going to be like 2001. In 2001, everyone came in and they wrote everything, they all wrote multi-lines. I don't think you are going to see that anymore. I wonder if you're going to see people come in who are going to write less lines of business. They are going to say, I'm really good at cat risk, and we are just going to write these lines. I don't think you are going to see people writing casualty and P&C, I wonder if you're going to see people be more narrow in their focus.

SHERMAN TAYLOR

There is always room for new ILS start-ups and the key to attracting fresh capital is creating a value proposition that contrasts other options in the capital market. Investors are selective, but ultimately chase returns, diversity and value, all of which the ILS asset class can offer.

RICK PAGNANI

Certainly the possibility exists but what strategic advantage will they bring to the table? If they are simply a clean source of capital, then there's no significant differentiation or niche being filled because existing managers can establish new funds with bespoke mandates. It's undeniable that current market conditions have served to poke the private equity bear. There are any number of NewCo business plans on the street, but we are not sure how many will gain traction particularly in light of the uptick in recapitalization activity. Again - a new ILS company could emerge but without sponsorship, access to direct business, a front and leverage, it will be challenging on a relative value basis.

LAURA TAYLOR

The past 3.5+ years have created a lot of data for both stewards of capital and capital providers. As an industry we have updated information on exposures and replacement costs. We have new data on how different markets and cedents respond when losses exceed initial expectations. Lastly, we have seen the impact of opacity to different market instruments. All of this suggests that the existing capital in the market (traditional or otherwise) is equipped with new information and is requiring the industry to reprice.

It's worth noting that ILS capital is concentrated in property / catastrophe risk. Past years have shown that certain structures do not serve investors well as a way to invest in the market. This year's pandemic shows that there are certain exposures which cut much more broadly across lines of business, so the capital need will not be limited to ILS-type lines but also broader casualty / health and life and other businesses. Leveraged balance sheets for public, rated entities will be strained in a way that ILS capital may not be able to address.

NEVILLE CHING

Small but highly skilled management teams will likely be launched in Bermuda and other similar user-friendly jurisdictions to take advantage of the rising tide. These will be low expense, lean, analytically focussed vehicles, utilising more efficient collateralisation methods that work in tandem with a rated balance sheet. These new entities are already on the production line, there will be some old and new faces on the virtual trading floor. Product will be streamlined and more class, peril and territorial specific than ever before.

Aaron Garcia

AARON GARCIA

Historically, the post-crisis environment has typically been fertile ground for start-ups and we may see history repeat itself in 2021. However, established managers will neither be distracted by the requirements of a new start-up nor the pressure to deploy, which will enable them to solely focus on finding the best opportunities to build an attractive portfolio and improve capital efficiency.

LAURA TAYLOR

There are more ways than ever for new capital to enter the re/insurance market – catastrophe bonds, sidecars, into existing companies (as we have seen via several new equity issuances) or funds, with new or existing managers. All proposed start-ups face the same classical challenges: lack of track record, but also a lack of data from the most recent years as well as less experience in the complex issues of collateral and claims management. We always expect innovation from existing or new market players, but we know first-hand that it sounds easier to create a new firm than to do so successfully.

TOM JOHANSMEYER

It's important to think past the next 12 to 18 months. Tight capacity because of prevailing market conditions certainly suggests that more capacity would help, and that startups could be instrumental in bringing that capacity to market. But, what will happen to those startups — or any existing players they supplant — three or four or five years from now, when market conditions begin to soften and there's a lot more capacity than the market needs?

The notion that there's an opportunity to simply dump more capital into the industry via new ILS fund managers that launch in a "class" of 2020 or 2021 seems a bit more difficult for me to wrap my head around. Yes, there's clearly a need for capital, and it seems like the reinsurance rate environment would favour new entry. The first question, though, is whether the reinsurance rate environment will continue to support that capital, especially if, a decade from now, end investors have seen their returns slide rather significantly. The second is whether the need for a profound increase in capacity would be able to hold for the long term, or if, as rates slide, we see an "excess capacity" environment that ultimately leads to degraded pricing and soft market terms.

STEVE EVANS

Do you expect the impacts of the Covid-19 pandemic to accelerate innovation in the re/insurance and ILS space? And, what types of innovation do you expect to come from this event?

LAURA TAYLOR

Absolutely, everything is on the table for innovation no matter how small or large. If existing businesses don't or won't adapt and change then we'll see new entrants capitalize on the opportunity. One example that many of us have focused on is applying technology to risk analysis, monitoring, and claims, for example – new sensors and data sources may help in the evaluation, underwriting, and settlement of future risk transfer contracts.

BRAD ADDERLEY

I think it is going to strengthen the ILS space, no question. I think it is going to strengthen the ILS space because rated carriers have been weakened by the business they wrote. Say you wrote cat risk which is not strong language and it looks like you also wrote business interruption by accident, these people now no longer have the capacity to write as much business because they themselves covered business that they thought they didn't cover.

So, I think that's going to happen and it's going to feed into the ILS market's hands, which I think most people agree is not going to be affected by this.

KATHLEEN REARDON

Covid-19 has once again highlighted the growing protection gap. New capital, likely in the form of ILS, can be brought to bear to provide the non-damage business interruption protection sorely lacking in the existing markets. In addition to traditional insurance products, businesses need to protect their intangible income statement risk as well as the more tangible balance sheet risk.

Laura Taylor –
Everything is on the table for innovation no matter how small or large

DAN MALLOY

Society will be different; the economies will be different. After big shock events, change is inevitable - this has been evidenced throughout history. For example, the Great Depression was clearly a catalyst for Social Security in the US, and the knock-on effects of World War One led to women getting the right to vote – and there are countless more examples. Insurers and reinsurers will face a new environment. By definition, in order to be successful, we will have to be innovative.

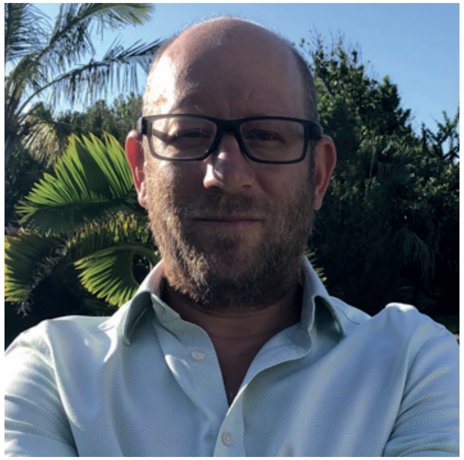
TOM JOHANSMEYER

I have mixed views on this. First, I hope it does. I really do. In general, we all know that the global reinsurance industry has historically shown a reluctance to progress. In fairness, I think this perspective is somewhat dated and that we've seen some progress. In this case, as a result of Covid-19, I can see a palpable interest in accelerating innovation. Some of it is opportunistic, of course. This is a massive protection gap loss event, and there's an opportunity to generate shareholder and end investor value. However, some of the willingness to accelerate innovation is also existential.

Effectively, there's a market for pandemic risk that's going to try to emerge. There will be companies that need to buy specific protection, and there will be players interested in selling that protection.

The biggest barrier to innovation as a result of COVID-19, from what I can see, is the daily grind we face as an industry. Many companies are cleaning up their books post-April and planning their June 1, 2020, allocations to the Florida market. After that, there's a belief that not much capital may be left to work with, although we may see some restructuring of programs renewing in July to release a bit more capacity.

Tom Johansmeyer – **Effectively, there's a market for pandemic risk that's going to try to emerge**



RICK PAGNANI

As I said before, I think Covid-19 will engender new product formation in addition to change the way we conduct our business. Those products will range from new insurance covers for pandemics to new funding vehicles for De Novo companies and recapitalization for the established market participants. Furthermore, we are going through a period of product expansion. It is not necessarily new products, but products that were created in the past that are now getting traction in the market. Parametric covers are a perfect example. I think they owe their newfound acceptance to the challenges associated with the last three years in terms of losses and valuations. Managers and investors crave transparency and these products serve to facilitate both.

SHERMAN TAYLOR

Across the insurance industry, we expect that insurance risk engineering will change the way risks are viewed and covered. We are likely to see a move towards stronger and more specific exclusion of certain risks like pandemic related losses. We can expect the same will happen with ILS. Separately, as the question of how to cover the type of losses that comes from an event like a pandemic may be answered by ILS, and we can potentially see the market for pandemic insurance become an ILS specialty.

AARON GARCIA

The need to resolve uncertainty for capital providers will drive structural changes to the treatment of risk. Perhaps new reinsurance instruments will be sold with narrower coverage, or the legacy market entrains new forms of capital and investment structures to address the promise to pay product. Both trends will likely see some traction, and will help to solve for capital efficiency up-front. But the utility of the insurance product is its ability to indemnify the policyholder in times of distress, and as such there's no easy resolution for this uncertainty. All the talk in recent years has been of narrowing the protection gap in order to open up new markets to abundant capital. That challenge has not gone away, but there is now an urgent parallel problem – in a time of widespread economic distress the need to reduce frictional costs through the value chain has arguably never been greater.

STEVE EVANS

And what about the trading outlook, Neville? From what you're seeing on the broking side, do you expect technological advancements and innovation to alter the landscape here moving forward?

NEVILLE CHING

The trading outlook is extremely positive and a blend of experience coupled with technical prowess to bring trading practices into the new world will be key to navigate through the challenges. Product innovation to meet the client's demand will also be important at all stages in the insurance / reinsurance distribution chain. Trading from the spare bedroom cannot be the new normal so new compliant work space practices will need to be designed.

The Catastrophe Bond market will continue to expand however the level of attachment has been typically at the territory and peril specific, remote end of the risk curve. The amount of capacity traded via Industry Loss Warranty product is also set to rise quite significantly and a number of ILW focussed funds have proved you can trade through the recent attrition Catastrophe loss years in the Green. They have achieved this by skilfully knitting together a balanced and diverse portfolio. Investors are more interested in accessing risk via the indexed based covers than they have been for many years. Demand is naturally significantly up.

Neville Ching

STEVE EVANS

How significant might the trapped collateral issue be from Covid-19 for the ILS sector?

RICK PAGNANI

There's the possibility for this to be a significant issue for certain managers. Depending on the portfolio construction by ILS asset type, geography, and class of business, there is the potential for meaningful judicial and/or legislative risk. I'm not saying how successful these potential challenges to underlying insurance and reinsurance contracts will be; but I am certain that they will take time to resolve. It will certainly be a challenge for those that lack a direct (re) insurance sponsorship as they will face significant "buffering" issues. The volatility associated with these losses could be significant as well as the half-life. I would think that some managers will be having some interesting and energetic conversations with their (retro) cedants in the 4th quarter of this year.

LAURA TAYLOR

We assume that the overall impact on the industry will be complex, and that will mean that capacity providers of all kinds will have to set aside reserves to cover the uncertainty. For collateralized contracts, that means collateral will be "trapped" (meaning, withheld and not usable immediately for new risk). For traditional "promise-to-pay" contracts that depend upon a credit rating, that means that more of the equity of capacity provider will have to be set aside and therefore will not be usable for new risk, in the same way. The leverage of collateralized providers is very low (total limits provided are not much larger than total capital if at all) whereas the leverage of uncollateralized providers is much higher. In both cases, the requirement to reserve against claims uncertainty will certainly impact everyone, but under both business models some entities will be untroubled and others will be quite severely constrained.

AARON GARCIA

There is currently a disconnect between reported Q1 reserves across the industry and some of the industry loss scenarios that have been mooted by analysts of the market. Looking ahead to the January 2021 renewals, and absent other major events in the second half, if reported reserves do not increase by year-end then the volume of trapped capital will likely be less consequential. However, if losses approach the levels contemplated by some market analysts then trapped collateral levels will be high.

Moreover, if there are further loss events in H2 2020 then aggregate contracts (among others) will be at risk of impairment, and highly likely to be trapped through the January renewals. As well as uncertainty surrounding the amount of trapped collateral, we must also contemplate duration uncertainty. Business interruption losses will take time to resolve – in the first instance if there is any legal challenge in respect of coverage, but also as a function of the event duration and claim settlement time, which will likely be tied to the annual accounting cycle for insureds.

SHERMAN TAYLOR

The trapped capital issue will be with the ILS industry for a while, but Covid-19 will more likely have less direct impact on the sector. The selling issues seen earlier this year at the height of Covid-19 related social distancing was in part due to the inability to effectively conduct road shows and the need to reinvent processes involved in the transactional work. These issues have been largely resolved and there should be a gradual return to normalcy or a new version of normalcy.

STEVE EVANS

And what about its reach? Is the trapped collateral issue likely to extend across the ILS sector, or is this going to be more of a challenge for certain sub-sectors, Kathleen?

KATHLEEN REARDON

Trapped collateral risk for ILS is quite probably in the proportional sidecar segment, with cat bonds largely immune and retro less exposed. Given much of the risk transfer that ILS is exposed to is in the property catastrophe segment, we will only see significant trapping in portfolios where loosely worded exposure or geographic exposure results in coverage being provided by the insured's portfolio. I think it's still a little early to know. We'll likely see the details start to emerge in July and August.

STEVE EVANS

Pandemic risk may hang over portions of the ILS market for a time, coming with a longer-tail than we're used to. What can Bermuda, its regulatory environment, and its ILS community do to ensure market traction is sustained going forward if uncertainty persists?

TOM JOHANSMEYER

The global re/insurance industry is going to be crying out for a commercial solution, and the Bermuda market is well-positioned to deliver on this need. Bermuda players should spend the summer preparing risk-transfer capabilities for pandemic to start marketing in September and then carry through the fourth-quarter run-up to the January 1, 2021, reinsurance renewal. If we aren't seeing a few hundred million dollars in parametric pandemic risk transfer at year-end, then our market will likely have missed a major opportunity to have expanded its service to the global community of end insureds.

DAN MALLOY

To the extent you believe the pricing and modelling of those exposures are credible, there is a mechanism for buying and selling an annual re-trading for longer tail exposures. An ILS investor looking at how to manage longer tail exposures can look to the Lloyd's of London market as a system where longer tail risks are taken up front and then re-priced annually and passed on to future investors.

Another way is to create alternative forms of coverage, as has been done in the past with long tail exposure. For example, the standard Bermuda Form policy was developed in response to the collapse of the US excess lability insurance market in the mid-1980s. A number of excess liability insurers were subsequently established in Bermuda, funded to continue to write this form of insurance. There are plenty of analogies of similar market reactions to the demand and supply imbalance, which resulted in new normals.

Kathleen Reardon –
Uncertainty is simply another form of risk

KATHLEEN REARDON

Uncertainty is simply another form of risk. Bermuda's mature yet innovative regulatory environment and the broader community can provide the framework to help manage this new type of risk to ensure the smooth operation of an efficient ILS market. This is an opportunity for the industry to devise a means to solve the trapped capital conundrum.

SHERMAN TAYLOR

Bermuda's regulators have done a lot to provide a stable and innovative environment for ILS and insurance market as a whole. The jurisdiction should not only maintain this course, but should get its success stories out to the market as widely as possible. It is important for the jurisdiction to draw contrasts and differentiate itself where possible because Bermuda has a unique value proposition for the ILS market.

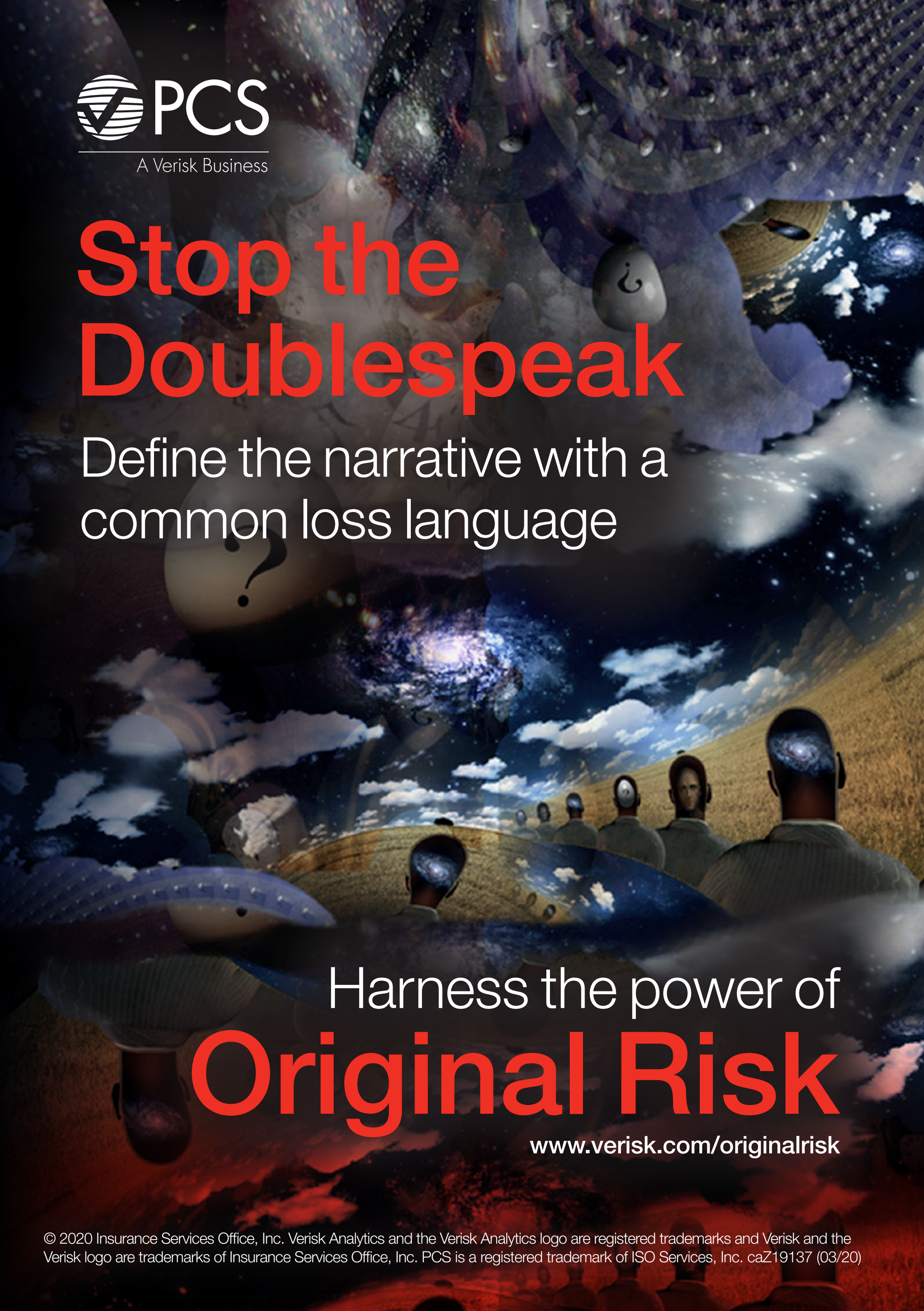
AARON GARCIA

Bermuda is the pre-eminent ILS jurisdiction. Recognising some of the root causes of market dislocation due to Covid-19 can help ensure that it competes hard and maintains pre-eminence. Pricing aside, the main themes include policy coverage, capital efficiency and valuation stability. With the exception of coverage, these themes are not new, and have seen some progress in the last few years. In respect of the other themes, if uncertainty persists, there is an opportunity for legacy structures to alleviate capital constraints to live business capacity. In turn these legacy structures would benefit from clarity on valuations and claims development scenarios.

BRAD ADDERLEY

Is Bermuda good at handling long-term capital? Because if the pandemic continues, that's what becomes important. I think Bermuda is good at handling long-term capital. We have seen that. The obvious example is the life business itself. Life business in Bermuda is growing exponentially, the amount of new life businesses we are building is significant and these are long-tail businesses.

If we say to ourselves, why Bermuda? I would say it is because of the track record. It's that simple. We have been around for so long that we should have more new business. The ILS space traditionally over the last eight years has been in Bermuda. And, so, we continue to see the marketplace evolve, and if this crisis goes on for a long period of time, Bermuda is the only jurisdiction that can handle it, and we continue to handle it because that's what we've been doing.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