



News release

Date: 4 September, 2012

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Insurance-linked securities: Are we at a tipping point?

- ***Insurance linked securities have seen some remarkable growth in 2012, which supports the notion that ILS has distinct benefits for both reinsurance and capital markets***
- ***A new paper from PwC co-authored by PwC Bermuda's new insurance leader, Arthur Wightman, explores the potential for ILS, including certain barriers that will need to be overcome if it is to continue to move into the mainstream***

BERMUDA: For reinsurers, ILS represents an alternative to traditional reinsurance. In the less than 20 years since the launch of the first insurance-linked securitisation, the ILS market has now grown to 14% of the global catastrophe reinsurance capacity, with the market now valued at more than \$15 billion – and this growth is expected to accelerate.

“So far in 2012, we have seen a surge in capital market convergence with reinsurance. The sector is seeing lots of activity and Bermuda is in the driver’s seat of much of this, with a wave of start-ups that are more akin to asset managers than the traditional reinsurance structures of the past. For instance, earlier this summer, there was the announcement of the biggest catastrophe bond to date by Citizens Property Insurance of its Everglades Re Ltd. Bermuda cat bond worth \$750 million, which is half of its budget. There have also been announcements from major Bermuda reinsurers of collateralised reinsurance vehicles funded in part by capital markets,” says Arthur Wightman, PwC Bermuda’s insurance leader.

ILS has sometimes been portrayed as a threat to mainstream reinsurance – perceived as taking away investment and risk transfer business, however, more and more traditional market participants are setting up their own ILS vehicles, teams or segments.

“ILS allows investors to move in, capitalise on their investment and withdraw more quickly than mainstream insurance. Further, ILS products have become more standardised – with the market getting more used to them. For these reasons, many investors now see ILS as an opportunity to diversify their portfolios, while achieving attractive risk-adjusted returns,” he adds.

But while ILS has cemented its place as a complement to traditional reinsurance, it still has a long way to go before it can realise its full potential. This is the subject of a recent research paper released by PwC, co-authored by Mr. Wightman and Achim Bauer, PwC UK’s Insurance Strategy Consulting Leader. Called *Unlocking the potential of ILS*, the paper looks at the future prospects for insurance-linked securities, and



discusses how sponsors and investors can overcome fundamental barriers to help move ILS into the mainstream.

PwC has developed analysis in which it looks at what external dynamics will influence the shape the insurance market. Called STEEP (social, technological, environmental, economic, and political) drivers, the paper looks at each of these in terms of how developments in these areas could influence the development of ILS.

“The relationship between global economic development and mounting catastrophe risk provides an indicator of just how valuable ILS could become. The estimate \$15 billion claims from the floods in Thailand in 2011 provided a wake-up call on just how much the global risk landscape is changing. ILS could play a crucial role in helping to manage these risks, simplifying risk transfer, bringing in much needed loss absorbing capacity and providing an efficient way to match risk, capital and reward in different parts of the world.”

The report also considers that ILS will need to overcome a number of barriers before it can reach its potential.

“In particular, sponsors have to overcome the wariness of a product that is seen by many investors as opaque and uncertain, much in the same way as they view traditional reinsurance. It states that the key to this is being able to cut through the complexity of ILS and forge a better understanding of how the structures work, provide better risk insight and demonstrate how this matches up against the potential rewards.”

“Once market participants are able to tackle these challenges, we could begin to see the critical mass of trading that would move ILS out from its niche and into the mainstream. These innovators and fast-followers include investment banks, specialist ILS vehicles and new capital providers from the emerging markets.”

Mr. Wightman will be travelling to Monte Carlo for the reinsurance industry’s premier event, Rendezvous 2012, which runs September 10 and 11, where he will be discussing ILS and other opportunities and trends facing the industry.

You can download a copy of the paper, *Unlocking the potential of ILS*, at pwc.com/bm

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