

Bermuda Reinsurance 2014

Charting a strategic course in unsettled waters



‘The forces driving change in the reinsurance market have continued to intensify since we met last year. These forces are both structural and cyclical and are driving the market towards a point of more fundamental dislocation.’

PwC Bermuda Territory and Insurance Leader, Arthur Wightman

Conference summary



*The challenges facing the reinsurance market have intensified in the past year. But reinsurers are evolving and innovating, resulting in a more sophisticated, better equipped and efficient market today, the ninth annual **Bermuda Reinsurance Conference** heard.*

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“Low interest rates, low growth, an abundance of capital, customers who are demanding even more specialised, creative and finally targeted solutions, brokers placing business towards narrowing panels of reinsurers with the highest rating or greatest expertise – these and more represent the challenges facing CEO’s today. In spite of the complexity there is no shortage of fierce competitors who’ll leverage the disruption to create competitive advantage,” said PwC Bermuda Territory and Insurance Leader, Arthur Wightman.

Sponsored by PwC Bermuda and Standard & Poor’s Ratings Services, and titled **Charting a Strategic Course in Unsettled Waters**, the event was held this year on November 12 at Pier 6, Front Street, Hamilton.

More than 200 reinsurance industry leaders and professionals were joined by

senior credit analysts from Standard & Poor’s and leaders from PwC’s reinsurance practice for six informative and interactive panel discussions.

“The reality of today is that hunkering down in the hope of a more favourable rating environment ahead is no longer a viable strategy for survival,” Mr Wightman said. “Even with lower costs and some premium uplift in premium rates, many reinsurers will struggle to sustain new investment and competitive relevance.

“The ability to establish a value proposition that is differentiated, source new markets where pricing is at a premium and innovate outside the commoditised corners will truly set a course for long term success. There is no one model for the future. Indeed it is the differentiation and ability to play to your particular strengths that will be crucial.”

Guest speaker at the conference, Stephen Catlin, CEO, Catlin Group, said, “I do believe personally that some of the fear that has been propagated (about the reinsurance market) is unfounded.”

He continued: “I don’t see alternative capital as a threat, I see it as an opportunity. It offers a different product - it’s a commodity as opposed to what the traditional transfer market offers.”

“I will leave you with two thoughts. One – we are very fortunate in that what we do adds social value. We should be proud of that and we should talk about it. The second point is relationships count – it’s important. It’s the foundation of our industry and long may that live in the future.”

View From the Top:

As soft pricing persists and growth opportunities remain elusive what actions must reinsurers take to remain relevant and drive competitive differentiation in an increasingly crowded market place? A panel of chief executives discussed that and more.

“As soft as you think the market is, in terms of risk, last year was an outstanding year. And prices while they are down, are not down anywhere near their absolute lows,” said Don Kramer, Chairman and Chief Executive Officer, ILS Capital Management. “What we do see, however, is a change that is affecting the reinsurance brokers, because what we are seeing now is lot of insurance linked securities and other kinds of things that are going around the brokerage markets.”

Mr Kramer said there are massive changes coming forward in the entire institutional market.

“But it doesn’t mean the market is over, it doesn’t mean people don’t have to buy reinsurance. It just means we’re going through an interesting period and it requires a lot more analytics than it’s had before - as to diversification and portfolio analysis in terms of where you write.”

Costas Miranthis, President and Chief Executive Officer, PartnerRe, said the industry is better equipped to deal with tough times.

“I think the reinsurance market today is far more sophisticated than it was in the late 1990s,” Mr Miranthis said. “Although today you find some reckless players, it is very difficult to find somebody who is

completely irresponsible - people have models, access to better skills, and frankly the quality of the human capital in the industry has improved enormously over last 15 years or so. So some of the excesses and some of the stupid behaviour that you may have seen 15 years ago, I don’t believe it is around today, so that is a change and a change for the better!”

Mr Miranthis continued: “Secondly, I think that the degree of transparency has improved. Fifteen to 20 years ago a lot of the reinsurance capacity was coming from divisions of bigger organisations. A lot of the economics of the reinsurance industry were not particularly transparent to the equity investor. That has changed dramatically over the past ten years particularly as capital has been moving to set up new companies here in Bermuda.”

Jeremy Pinchin, Chief Executive Officer, Hiscox Re, “The changes are quite dramatic. It is always deepest and darkest when you get to the middle of cycle. And it is always very difficult at that time to tell what is truly a long-term change and what is a short-term imbalance.”

He added: “Do I think there is a fundamental change? Yes. We have got access to new capital and mechanisms for it that are set up that we can’t go back

from. How far that goes ... I don’t think I can tell. But certainly as a reinsurance organisation we are used to different capacity providers.”

He concluded: “Yes I think there is a fundamental change with capital coming into the market ... but I think it is too early to tell at this stage whether it’s a full change or not until we see some real tests of the marketplace – with some big losses.”

Mr Wightman said: “There’s no doubt we are in a difficult period structurally and cyclically, but I also think this is forcing executives and other stakeholders in the industry to concentrate on both innovation and developing where the next wave of growth can come from.

“It’s also challenging executives to look at their operating models – what do they want to be? Is it scale, is it building out a richer investment strategy? These are some of the questions that I think are so fundamental to focus on and I know many companies are concentrating on just that very point – what do they want to be in the next two to three years and then over the next decade.”



Moderator: Taoufik Gharib, Director, Standard & Poor's Ratings Services
Jeremy Pinchin, Chief Executive Officer, Hiscox Re
Don Kramer, Chairman and Chief Executive Officer, ILS Capital Management Ltd
Costas Miranthis, President and Chief Executive Officer, PartnerRe Ltd.
Arthur Wightman, Territory and Insurance Leader, PwC Bermuda



Stephen Catlin, CEO, Catlin Group Ltd



Moderator: Scott Watson-Brown, Asset Management Leader, PwC Bermuda
John Rathgeber, Chief Executive Officer, Watford Re Ltd
Aurora Swithenbank, Managing Director and Co-Head of Insurance Structured Finance, Goldman Sachs
John Berger, Chairman, Chief Executive Officer and Chief Underwriting Officer, Third Point Re



Re-balancing Risk and Return Across the Whole Balance Sheet

In an environment of depressed pricing and low interest rates, reinsurers seeking risk adjusted returns say they are focusing on the agility and responsiveness of their investment and underwriting strategies to changing market conditions and opportunities. Reinsurance leaders agree that a number of major trends will influence the industry over the next five to ten years.

Discussing misconceptions about hedge fund reinsurers, John Berger, Chairman, Chief Executive Officer and Chief Underwriting Officer, Third Point Re, said, that the hedge fund model was not a new model.

“Most companies - traditional companies - spend 90 percent of their time on the underwriting side and have a very conservative low risk investment side,” he said. “That worked well until interest rates plummeted so now there’s an advantage to being smarter and more aggressive on the investment side.”

He said: “The future is going to get tougher and tougher. A common question people love to ask is how big a loss can change the market. I am not sure there is one single loss that would change the market. There is a lot of capital out there and a lot of capital waiting to come in. I think this is the way the market is today, and assuming this will

continue it is going to slowly deteriorate for as far as the eye can see. Now do you have a gameplan that works in that environment?”

Aurora Swithenbank, Managing Director and Co-Head of Insurance Structured Finance, Goldman Sachs, said: “Increasingly traditional reinsurance and insurance companies have been going into alternative assets. In some cases that means hedge funds, for others it means private equity, for some it means structured assets like CLOs. I think there is a lot of focus on increasing - in an appropriate and risk-managed fashion - increasing investment returns and that’s something certainly the markets are focused on when we look at valuations.”

John Rathgeber, Chief Executive Officer, Watford Re, said: “There’s much less cat risk for instance than you have in typical reinsurers. Another aspect is the premium to surplus leverage is going to be much less. It’s a rebalancing ... a recalibration.

On the asset side there is more risk. It is not investment grade corporate credit, but there’s capital there to back that risk. In the end it’s all about matching capital to risk.”

He added: “It’s been a fascinating time period - the pace of change has been unprecedented. It’s obviously a very challenging environment and that’s largely the reason, though, that this vehicle was set up - to try to respond to difficult market conditions, to try to find a way to find a niche to navigate through the difficult times. We believe again it’s back to execution, you’ve got to deliver and execute on your strategy.”



Moderator: Kevin Ahern, Managing Director, Standard & Poor's Ratings Services
Mike McGuire, Chief Financial Officer, Endurance Specialty Holdings Ltd
Joe Henry, Chief Financial Officer, Axis Capital Holdings Ltd
Jason Porter, Director, Standard & Poor's Ratings Services

Navigating the Course: The CFO Perspective

With confluence of current market dynamics, the level of transactional activity, the required focus on capital management, the pace of regulatory change, and the increasing focus on technology and data, the need for strong financial and strategic stewardship is at an all-time high. Our panel weighed in.

Joe Henry, Chief Financial Officer, Axis Capital Holdings, said: "One of the biggest challenges that I have is how to look at deployment of capital. At Axis, we really look at three or four things. The first is, can we put it to work in the business? Secondly, can we make some strategic investments? The third would be M&A. And then last it's returning capital to our shareholders in the form of dividends and share buybacks."

Mike McGuire, Chief Financial Officer, Endurance Specialty Holdings, said: "Frankly, we are getting close to the point in the cat space where the return profile just does not support significant retentions. We are maintaining our front footprint, but we are ceding a fair bit of that business away to protect the net position."

"I think the next time we see a series of big events I think you will see some differentiation among companies out there in terms of their performance -

those that are viewing the soft market as a time to increase retentions or those that are viewing it as a time to rationalise and control the risk and reduce their net retentions. It will be very interesting to see post event what happens."

He added, "First and foremost for us, deploying capital to build our business organically is a key focus for us."

Jason Porter, Director, Standard & Poor's Ratings Services, noted: "With excess capital we have seen certain companies, not all companies, but a handful start to look a little more closely at their excess capital and say 'how much do we really need?'"

"I think that it's a potential that maybe the truer absolute levels of excess capital might be slightly less in the future but I think it's a sustainable position that the industry remains well capitalised."

Wall Street meets Front Street

How do institutional investors assess the variety of reinsurance asset classes that are available, and how do investment decisions vary with changes in the reinsurance cycle? As the abundance of capital creates supplier-demand disruption and compresses margins, our panel looks at whether the influx of capital is set to slow?

Giving a perspective on the current state of market, Jeff Sangster, EVP and Chief Financial Officer, Validus Holdings, said: “I don’t think we are going out on a limb by saying we believe this is a structural change in the market with the alternative capital.”

In a lot of ways, Mr Sangster said: “That change is adding efficiency to the market. Taking out for certain risk intermediaries where the investors can support that risk directly without the additional input from those intermediaries is a more efficient approach. That said, that’s not the right approach for every risk, so there is a balance that needs to be found there and I think we are in the process of finding that balance.”

Michael Hamer, Partner, Albourne Partners, said: “I would say that there’s been a very rapid rate of innovation and some of the innovations out there have not yet been tested by severe events, so, as has happened in other areas, that may show some flaws. But generally speaking, what has happened in the last five to six years has made the industry potentially a lot more efficient.”

Discussing what differentiates one reinsurer from another, Jay Cohen, Managing Director, Bank of America Merrill Lynch Global Research, said: “What distinguishes them is frankly what happens over time. What happens when there are catastrophe losses - how do they fare? How do they manage their capital? There are really three things I am looking

for them to do: Price the risk well, manage the risk well, manage their capital well. Unfortunately, you only see that over time.”

Mr Sangster said: “It seems fairly certain that the alternative capital is here to stay. Traditional reinsurers and insurers are not going away, that’s always going to be a piece of the industry. The big question is where that balance ends up. Is it 50-50, is it 70-30, one direction or the other? I think when that question gets answered ... when that shift finally settles that will be the interesting thing - to see how the industry looks.”

He added: “I don’t think you want to be purely in one camp or the other because there is going to be some combination at the end of the day.”



Moderator: Arthur Wightman, Territory and Insurance Leader, PwC Bermuda
Jay Cohen, Managing Director, Bank of America Merrill Lynch Global Research
Michael Hamer, Partner, Albourne Partners Ltd
Jeff Sangster, EVP and Chief Financial Officer, Validus Holdings Ltd

The Structural Evolution

Does the rapid pace of structural innovation in the market reflect that reinsurers recognise that efficient capital management and capacity deployment is now as important as the delivery of knowledge and underwriting excellence? Are third party capital strategies a competitive advantage for reinsurers, or is the offering of rated and collateralised products now a necessary part of a reinsurer's strategy to remaining relevant? Our panel discusses these themes.

Discussing alignment of interests, Aditya Dutt, President, Renaissance Underwriting Managers, said: "The cornerstone of aligning interests, in our opinion, is your investors should follow your fortunes, in some way, shape or form. Our long-term vehicles are clearly built on aligning our economic interest with our partners."

He continued: "We have never done a transaction or sponsored a vehicle where we haven't put money in. Often we are the largest investor alongside out partners. That's one way to show it. Another way to show it is to take the risk side by side with your partners. In my view it's very simple to align interest- it's have economic skin in the game."

Guy Swayne, Managing Principal, Nephila

Capital, said: "One of the key things we have done over our 16 to 17 years is continue to evolve. Continue to see what's going on in the marketplace, and where the need is in the marketplace."

Discussing new opportunities, he said: "In the last three to four years we have spent a lot of time looking at – in the property cat space, which is the only arena we play in – what we call unmet demand, where there's pockets of risk that should be in our market that's being held by governments around the world."

Mr Swayne added: "At the end of the day we've got to provide the solutions and the products that our buyers want and whether that's rated balance sheet, collateralised, bond form, that's their decision, we just

need to be able to offer those products, which all three of us do."

Bill Pollett, President and Chief Executive Officer, Blue Capital Management, said: "One of the things that has happened over the last couple of years and it has really accelerated over the last 18 months is the innovation in our industry. What's happening is that the different collateralised platforms are bringing innovations to the market that are really making the traditional underwriters think and work much harder ... to find solutions that work for their clients rather than selling the same products they have been selling for the last 10 years - and that's great for our clients."



Moderator: Gary Martucci, Director, Standard & Poor's Ratings Services

Guy Swayne, Managing Principal, Nephila Capital Ltd

Bill Pollett, President and Chief Executive Officer, Blue Capital Management Ltd.

Aditya Dutt, President, Renaissance Underwriting Managers Ltd



Moderator: Matthew Britten, Managing Director, Insurance, PwC Bermuda
Kean Driscoll, CEO, Validus Reinsurance Ltd
Tom Hulst, CEO, Ariel Re
Kathleen Reardon, Chief Executive Officer, Hamilton Re
Charles Cooper, President and Chief Underwriting Officer, XL Re Ltd

Product Innovation & Distribution

Investors currently benefit from a variety of options or vehicles in which to deploy capital seeking reinsurance correlated returns. But has the innovation in serving the needs of the buyer kept pace with the innovation in serving the needs of the investors?

Kean Driscoll, CEO, Validus Reinsurance, said: "I would argue broadly speaking that where we have seen innovation hasn't necessarily been on the product side. There has certainly been tremendous innovation with respect to vehicles to facilitate capital inflows into our market space or to capture the risk profile of particularly 'nat cat', but the traditional market I think over the last century to century and a half has developed a product suite that is incredibly flexible. It may have been largely homogenised in terms of how it is sold. But true product innovation we haven't really witnessed."

"I think we are differentiating ourselves," said Kathleen Reardon, Chief Executive Officer, Hamilton Re. "As far as innovation – the sidecars and the cat bonds and the ILS industry is innovation that benefits the clients. Ultimately the cost savings gets passed on to the clients. But now I think we need to innovate again. I think we are on the cusp of change. What is the next innovation?"

She added: "To remain relevant I think you need to accept the convergence of the capital markets."

"You see a lot of reinsurers now looking on the insurance side ... and then you see the opposite. There are many insurance companies that are looking into the reinsurance space. So becoming relevant doesn't mean you need to be relevant in your sector. You can think beyond that and accept the convergence of various sectors."

Charles Cooper, President and Chief Underwriting Officer, XL Re, said: "There's been a lot of innovation in providing vehicles that allow investors to access cat risk primarily. I think what's happening though is the knock on effect of that is creating additional evolution by traditional reinsurers and alternative capital providers."

"I think everyone at this stage in the market is looking for a way to differentiate themselves and product innovation is a clear way to do that. I don't think it's been

especially fast and in large part it's been a reaction to all this additional capacity coming into the market and trying to figure out a way to get utilised."

Tom Hulst, CEO, Ariel Re, said: "I think the business is fundamentally - whatever your platform - about risk selection. I think over time the best risk assessors are going to be rewarded."

He continued: "From my perspective I think about it as can we as a business offer products that are relevant and useful and an effective value proposition to our customers."

"I don't really think as much about the model that we are offering that in. I think of us as risk assessors on behalf of our owners and in order to get the broadest opportunity of risk to select from we need to be offering a competitive and differentiated suite of products to people and doing so in a way that encourages them to place the business with us and come back for the next opportunity."

PwC Speakers



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