

ILS experts say investors undeterred, bullish on issuance activity

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By David Dankwa

Although catastrophe bond investors have suffered losses this year, investor perception of the value of these securities versus other fixed-income investments remain relatively high, according to market participants who remain bullish about issuance activity going into the new year.

Certainly, issuance activity in the second half of 2011 has not picked up as some forecasted, but a few notable transactions focused on both U.S. and non-U.S. perils have come to market recently, signaling investor appetite remains strong for insurance linked securities, or ILS, and cedents are willing to pursue alternative risk transfer.

Among the notable deals are AXA Global P&C's €180 million Calypso Capital cat bond and Munich Re Group's \$100 million Queen Street IV cat bond. Calypso exclusively covers European windstorm events and was structured and placed by Swiss Re Capital Markets.

Queen Street, which covers U.S. hurricane and European windstorm risks, was placed among a group of international investors, comprised mainly of investment funds and hedge funds, as well as insurers and reinsurers.

"There has been a lot of money flowing into the ILS space, and the money has to go to work," said Ed Hochberg, head of Towers Watson Capital Markets Inc., a unit of Towers Watson & Co.

The ILS market's focus on non-U.S. hurricane perils is high, particularly for European windstorm. Much of that interest is driven by the new PERILS index, which has benefitted the European ILS and insurance and reinsurance market by improving the transparency of industry losses. Recently, PERILS, which was formed by industry titans AXA, Allianz SE, Groupama SA, Guy Carpenter & Co. Inc., Munich Re, PartnerRe Ltd., Swiss Reinsurance Co. Ltd and Zurich Financial Services Ltd, reported that it has facilitated the placement of \$3.18 billion of capacity in the capital and reinsurance markets. Of that amount about \$1.42 billion was in the form of ILS.

"The fact that you've got a reporting site that is motivated and dedicated and committed to putting out data quickly after an event in a very granular fashion is phenomenal," said Rick Miller, a senior vice president at Towers Watson Capital Markets. "It's a great service they are providing."

He said investors did not withdraw their money from the space after the Japanese earthquake and have remained undeterred even as losses develop around Mariah Re, a cat bond covering American

Family Mutual Insurance Co. from severe U.S. thunderstorms. S&P lowered its rating on the bond last month and changed CreditWatch status on the notes to negative from developing.

"Maybe that is one of the byproducts of having professional ILS funds be part of this space versus just multi-strategy hedge funds. They get it," he told SNL.

According to Swiss Re, secondary trading volume of cat bonds surged after the Tohoku earthquake largely because "uncertainty prior to the release of data for the parametric index calculation created opportunities for trading desks, opportunistic buyers, and concerned sellers."

During the second quarter, issuance slowed dramatically due to a combination of cedents needing time to get acclimated to the updated RMS catastrophe model and investors needing to ensure expected loss calculations were correct, experts say.

"Every time you see some sort of incremental shock event among a particular peril, the cedents in that region would begin to ask more questions. They end up doing a relative value analysis, and with that analysis they compare the gross rate on line for the capital markets relative to what the traditional markets can provide," Miller said.

Some cedents end up not even having to issue a cat bond by engaging in the analysis and by virtue of telegraphing their thought process to the traditional market.

Miller said speculation following the Tohoku earthquake that the ILS market had escaped unscathed created a false public impression about the cat bond market. "It was effectively saying that what we were providing in terms of capacity was a hole-in-one insurance. The reality is that the capital markets, just like the traditional, are in this to take premium, or coupon or rate on line in exchange for capacity for real risk transfer. To lose money because of a Japanese earthquake, to lose money that relates to a severe convective storm or series of them or lose money as a result of a Christchurch earthquake, these are all risks that all the dedicated ILS investors fully recognize has a strong probability of occurring. They went into it with their eyes open."

Indeed, Hochberg argues that had the ILS market not sustained losses from the heavy catastrophes this year, it would have raised some serious questions about the products cedents are buying. "They are out of the money from these horrendous losses and they don't collect? That would have raised some questions about what they really buying. It would not have said very good things about the product." *i*