Reactions

New capacity shaking up reinsurance market

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New capacity from hedge funds, private equity, pension funds and other sources have come in the reinsurance industry in the past year which Tiger Risk think is great for the business.

The inflexibility of traditional reinsurers has allowed new capacity to enter the cat space, and it will not disappear once the short-term opportunity abates, believes property-cat specialist broker TigerRisk.

Capacity from hedge funds, private equity, pension funds and other sources of capital has come into the industry in the past year through vehicles such as new start-ups and sidecars. The low interest rate environment has made the uncorrelated returns in the cat reinsurance market relatively attractive.

“The new capital coming into the reinsurance business is significant and it will continue to come in. It is great for the business,” says Rod Fox, CEO of TigerRisk. “I always felt the insurance business was 10 or 15 years behind other financial companies, and that will continue to evolve and get more sophisticated.”

Marc Lauricella, partner at TigerRisk, says traditional reinsurers have allowed the new capacity to come in by not adapting their approach.

“The fact that the traditional market has not been able to bring new solutions to the market has left the door open to new capital,” says. “It has allowed investors to come into market without ratings. We believe the new pension fund money is not just a fad. Even in a post low interest rate environment we believe it will not just disappear, in fact it will even keep growing. These pension funds are sitting on vast amounts of money and looking for diversification. If it makes up just 1% or 2% of their capital, that is still a lot of money.”

The capacity is providing cover such as single-shot limits, and policies that wrap around limits provided by traditional reinsurers. “I’m not here to bash the traditional reinsurers but this new money is providing a slightly different view,” says Lauricella.

Traditional reinsurers may not be pleased to see new capacity come into the market, but Lauricella says it is a good development for buyers because it creates more stability.

“It will make the traditional market a little more competitive,” he says. “Reinsurers are concerned about price decreases, and there may be some but there have been huge prices increases because of what happened in 2004, 2005 and 2011. This may just stabilize pricing and allow buyers to buy more limit.”

Another interesting outcome of the new capacity is it may spur traditional reinsurers to consider providing coverage they previously would not.

“Another outcome is that reinsurers will be more willing to do multi-year transactions,” he says. “It would be a great option for clients because having to renew annually is a difficult model to fulfill. Clients depend on that capacity and when there are major changes in costs they can’t pass them on. It is still early, but there are some markets that would consider it."

However, the situation is not one that is simply good for buyers and bad for reinsurers. Traditional reinsurers themselves could gain by working with new capacity, such as the sidecars and joint ventures established by players such as RenRe and Validus. “You will see other reinsurers like RenRe and Validus acting as fronting carriers for institutional investors to get into the market very quickly,” says Lauricella.

Fox believes more reinsurers will look for similar tie-ups.

“Over time it will evolve that way,” he says. “Will it be everybody? No, but traditional reinsurers have an advantage because that is their business. [The new capacity] needs people like Ed Noonan and others, because human capital is the commodity here.”
Another trend Fox believes will continue is that of large reinsurance buyers reducing their demand.

“Reinsurers like to sell lots of different covers but now it is being bundled back in,” he says. “It is not necessarily being talked about, but it is happening. It is not the first time it has happened but I think it is here to stay for a while. It means less premiums for reinsurers, and that quality reinsurers are going to get a better share.”