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Catastrophe Bond Outlook for 2014

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GC Editor

The growing influence of alternative markets capacity is pressuring traditional reinsurers' business model and challenging them to compete against a model with lower-cost of capital that continues to enter the reinsurance market. Most reinsurance companies have responded to the challenge by leveraging their incumbent status on reinsurance programs, offering similar or better terms and similar or reduced pricing. Particularly, traditional players are emphasizing their ability to efficiently provide reinstatements, which are seen by many as a critical part of core reinsurance programs, particularly for working reinsurance layers. Traditional players are also hedging their bets and creating their own capital markets divisions to attract, manage and utilize capital from third-party sources whether in the form of fund management, managed accounts or sidecars. This will allow reinsurers the opportunity to securitize the most capital-intensive parts of the business while providing valuable cost-efficient capacity in other business lines.

Despite the significant decrease in ILS pricing over the past 12 months, investor demand continues to be robust. If insurers do elect to continue accessing capital markets capacity they may be kindly rewarded through enhanced terms, conditions and pricing. ILS managers continue to see interest in deploying large amounts of capital into the sector, but given the limited opportunities to actually deploy such capital, some ILS managers are maintaining a soft closed position with respect to bringing incremental capital into the ILS space. However, if opportunities do emerge, they are well positioned to call on such capital and offer attractive pricing.

As the catastrophe bond market continues to mature, more new sponsors are looking into the alternative market space for meaningful capacity and the expectation is that this trend is likely to continue through 2014. Also, bespoke parametric structures for non-peak risks are becoming more common, which is causing a wide range of corporate sponsors worldwide to evaluate alternative risk transfer capacity in addition to traditional indemnity coverage.

Finally, lower multiples (the ratio of spread - equivalent to net rate on line - to expected loss) as a result of the influx of additional ILS capacity have resulted in lower spreads. Insurers are also seeking coverage for more remote risk layers, which also corresponds to lower spreads.

The combined result has been a suppression of yields, which investors may want to offset by looking at more risky programs and/or risky layers that pay a higher spread.

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