Leadenhall: scaling up doesn't mean compromising granularity

Reinsurers and ILS managers alike have been on a quest for greater size and scale in recent years, as "tiering" of the market becomes a hot topic at industry events.

Tiering essentially means that reinsurance buyers are becoming increasingly choosy about who to buy cover from and that top-tier reinsurers – those with the might to offer huge capacity – are getting increasingly preferential cover.

But Leadenhall Capital Partners CEO Luca Albertini argues that being in the top tier of providers does not mean an ILS fund has to build a highly concentrated portfolio of large-ticket bets.

Leadenhall has more than doubled its assets under management (AuM) in the three years since MS Amlin increased its shareholding in the London-based ILS manager to a majority stake.

The London-based manager's AuM stood at $1.8bn in October 2014 when Amlin exercised its option to increase its stake in the manager, and Leadenhall's portfolio is now valued at $4.2bn.

It could have been still higher, but the firm had to turn away around $200mn of subscriptions that came in too late to be put to work during the 1 June and July renewals in a manageable way.

Meanwhile, Albertini says that the firm's average participation on a reinsurance programme per fund has barely changed since it began in 2008 with seed capital from the insurer.

The ILS manager's average capital deployed on a single investment used to be $2mn-$3mn in its earliest days, but even now it has moved up to just $3mn-$5mn for each fund.

"We believe in the importance of a more granular group of relationships with reinsurance buyers," he says. "We kept targeting granularity as we grew."

Leadenhall was able to achieve this as it scaled up due to its relationship with Lloyd's reinsurer MS Amlin, which has a broad network of clients that reaches down to small regional insurers.

"It gives us access to a wide range of buyers including regional clients who don't have more than five or six lead carriers on their reinsurance programmes," Albertini says.

The first advantage of this approach is that it creates more diversification and reduces the potential damage to the portfolio from a large-scale disaster – or the "tail risk", in industry jargon.

Luca Albertini, CEO, Leadenhall Capital Partners

The second, he argues, is that it gives the ILS manager more flexibility to walk away from difficult renewal negotiations if premium levels on offer drop too low.

"The granularity means you can say no to a buyer and walk away without a major impact on our cash levels."

Trying to build a broad range of smaller positions might sound like the antithesis of behaviour that works in the context of reinsurer "tiering". Typically, the industry debate on this trend focuses on the idea that the large-scale carriers putting down major lump sums of limit will win out.

But Albertini suggests that a more granular approach still works for Leadenhall because it is positioned within the bigger MS Amlin net.

"The broader, the more complete your relationship with a protection buyer, the more relevance you have," he asserts.

"The result of the combination of MS Amlin and LCP is that it is helping key clients to see a sustainable, relevant counterparty that should be one of the prime actors on their programme."

In the competitive current market, where buyers are able to pick and choose their counterparties, Leadenhall is currently winning about 80 percent of its bids to deploy capital on reinsurance programmes.

Fronting up

Leadenhall is one of the largest reinsurer-owned ILS managers, each of which has its own spin on how to share and where to separate underwriting resources.

MS Amlin writes business on behalf of Leadenhall, in a practice known as "fronting" risk, but the two have independent underwriting teams.

The ability to borrow MS Amlin's rated paper is critical when Leadenhall is approaching a portfolio of protection buyers who prefer to face a rated carrier instead of a collateralised structure, Albertini says.

But where it is particularly crucial for the manager is in providing the ability to offer reinstatable cover, which offers buyers a second limit within the same contract year if the first lump sum of cover is fully drawn down.

At present leverage is not a core feature in Leadenhall's funds and the ILS manager generally fully collateralises the first limit of risk it assumes via the insurer.

But MS Amlin will bear the risk of a delay in the collateralisation of the second limit if a reinstatement is triggered when the relevant Leadenhall fund does not have immediate access to liquidity. The ILS investors are also entitled to the reinstatement premiums due in this case.

Albertini says that negotiating this arrangement was helped by the setting up of a rated cat bond retrocession structure that benefits Leadenhall vehicles.

The arrangement secured a BBB+ rating from Standard & Poor's last September, which provided an independent view of the creditworthiness of Leadenhall's fronted portfolio and its ability to repay its liabilities in full.

Whilst Leadenhall cooperates with MS Amlin in the execution of its investment strategy, particularly for the fronted business, it retains an independent decision-making process and this is made known to the buyers.

"It's important for us to have a dialogue with the client, and it's important for MS Amlin too – they wouldn't want our decisions to reflect on them," the executive comments.

Allocation policies have been set in place to cover any situations where the amount of risk transfer approved to the group falls short of what both parties want.

"We have not had to get out the calculators to work it out yet," Albertini says. "The relationship is going well and we make sure we proactively address conflicts of interest with both investors and regulators."

Preparing for diversification

Leadenhall has hired a portfolio manager that will join the firm in September to support its medium-term ambitions to move further into the specialty and facultative insurance sectors.

Whether or not ILS managers like it, more cyber and terrorism risk is creeping into mainstream property catastrophe treaties, Albertini notes.

But investors are also beginning to push for broader exposure to insurance risk, as some of the early adopters have reached their target allocation to catastrophe business.

One alternative insurance area where Leadenhall has already deployed significant capital is life ILS.

With some $1.8bn of AuM in life portfolios, it is the largest life specialist of the four ILS firms active in this segment. Again, the company has pushed this strategy in order to diversify its risk exposures.

The life ILS market is currently surging, which Albertini attributes partly to demand from cedants. "We are seeing some very large transactions where in order to participate you need to have scale."

A more stable regulatory environment has favoured greater use of life ILS for funding and capital raising purposes, although mostly in the private markets. Regulatory arbitrage is less of a feature of life ILS in Europe, while funding and risk transfer are the prime motivations.

> "The broader, the more complete your relationship with a protection buyer, the more relevance you have"

Life ILS are becoming an accepted tool in the corporate finance toolbox for life insurers, whether for mature books or new InsurTech initiatives and start-ups.

In this sector the manager is also looking to add new offerings by seeking to raise longer-term commitments for five- to 10-year lock-ins.

This will suit the life segment's longer maturity profile, with lower liquidity and longer repayment period deals being the two major challenges of the sector compared to non-life business.

However, it is also a more stable sector, Albertini adds.

Spreads on extreme mortality or health-linked catastrophe bonds have suffered the same type of compression as non-life cat bonds. But premiums in the embedded value market have been more resistant to pressure and have frequently even been improving, as life insurers entering into long-term business relationships increasingly value relationships over price.

Future growth

As one of two London-grown ILS managers, Leadenhall has been involved in industry groups that have helped UK regulators get to grips with the industry as they plan to launch a local ILS issuance framework.

Though the London insurance market is sometimes criticised for being an expensive place to do business, Albertini says MS Amlin's dominance in the local market means that staying in the UK heightens Leadenhall's relevance and access to quality business.

"We look forward to seeing shape of the final regulations, and we welcome the UK government's efforts to give the London market another tool to transact domestically. There is every reason why Lloyd's and the London market continue to attract a vast talent pool and overseas capital market players are seeking to establish a footprint in the London market," Albertini concludes.