ILS MARKET UPDATE

The Storm Before the Calm

Including an exclusive interview with Luca Albertini of Leadenhall Capital Partners LLP

WILLIS CAPITAL MARKETS & ADVISORY

July 2013

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Market Outlook

In sharp contrast to Q2, Q3 issuance is modest in most years. Indeed, while July tends to see some activity, August is usually quieter, with September then seeing some ex-U.S. issuance. This year will likely follow suit. After a nearly record breaking H1 2013, Q3 will involve more deal planning than deal making. These planning sessions will address some open questions for the market.

First, how far can the market expand beyond customary natural catastrophe perils (and extreme mortality)? To continue the same pace of growth we have seen in the last few years across cat bonds and collateralized re, sponsors will need to deliver and investors will need to accept a growing pool of perils. Some of these are evolutionary and not revolutionary, think earthquake risk in places like Columbia, Chile, Israel and even China. Others may represent a more radical departure from market norms. For example, will investors accept standalone U.S. terrorism risk if TRIPRA is non-renewed? Will casualty risk finally become more at home in the capital markets?

Second, what will happen with terms and conditions? Along with the rapid decrease in spreads in the last few quarters, we have also seen more flexible terms and conditions. This includes, for example, deals with “name your own reset” provisions allowing firms to change the risk-return profile (within a range) on an annual basis. Other H1 2013 deals have had more expansive event definitions to better parallel traditional reinsurance language (e.g. coverage for named storms instead of only for hurricanes for U.S. deals).

To some extent investors can price for these changes and should even welcome them if they bring more sponsors and deals to the market. This is particularly true if the high standards for transparency in both structure and collateral mechanisms that followed the Financial Crisis remain in place. On the other hand, a few bad apples (or sloppily structured deals) can spoil things as investors will assume that deals have hidden time bombs and price all new deals accordingly. Thus far, we have seen the market handling this shift in terms and conditions well as the more aggressive deals have resulted in pricing adjustments and narrower distribution to investors who feel they can adequately price for the changes.

Third, how will reinsurance partners react to the new pricing dynamic? Will they themselves access ILS, collateralized re and third-party capital more generally as a source of capacity? If so, will they use the savings to become more competitive at renewal? Alternatively, will the relative disappearance of the cross-subsidy from highly profitable U.S. cat business start to put upward pressure on ex-U.S. cat reinsurance? If so, will we see more ex-U.S. cat risk in the ILS market?

Fourth, when is the time to issue? For incumbent sponsors the thinking has moved from “if” to “when”. Insurers, who still represent the majority of ILS sponsors, are often resistant to timing the market. In the current environment, some sponsors are reconsidering as timing (as well tranching and other structuring and reinsurance program design choices) can improve ILS execution. To some extent, timing decisions will influence where the market ends up the year in terms of issuance numbers. Our current best estimate is $6 to $7 billion in non-life issuance (excluding private deals with limited information). If sponsors accelerate deal execution into 2013 that would otherwise have occurred in 2014, exceeding $7 billion seems quite possible.

Finally, sponsors will be watching the Atlantic and elsewhere to see what surprises Q3 2013 brings. The wrong storm or earthquake in the wrong place could change things quickly.

Q2 2013 Cat Bond Market Issuance Overview

The second quarter of 2013 saw $2.2 billion of non-life catastrophe bonds issued through 14 tranches (Q2 2012 saw $2.1 billion issued through 12 tranches). This follows on the heels of a historically strong first quarter in which the market saw $1.6 billion of issuance, and brings total non-life capacity issued year-to-date to $3.8 billion.

Nine out of the ten catastrophe bond sponsors were repeat issuers, with American Coastal Insurance Company representing the only new sponsor with its Florida-only, Armor Re issuance. The emergence of new sponsors within the ILS market is testament to the competitiveness of reinsurance equivalent pricing and is a strong positive signal to other first time sponsors considering capital markets solutions. Repeat sponsors included serial issuers Munich Re, Assurant, USAA, Travelers and other well-known market participants such as Allstate.

Q2 2013 Cat Bond Market Issuance Overview (Continued)

While the ~72% of cat bond capacity exposed to U.S. hurricane risk at the time of publication is very similar to that at the start of H2 2012, a number of diversifying bonds were placed in Q2. Notably, Munich Re's Queen Street VIII and the Turkish Cat Pool's Bosphorus I Re have offered investors exposure to Australian cyclone and Turkish quake respectively. It remains to be seen whether the success of these issuances, both of which were oversubscribed, will draw more sponsors of non-U.S. wind peril bonds into the market.

Q2 2013: Non-Life Cat Bond Issuance Summary

($ in millions)

Sponsor	Issuer / Tranche	Issue Date	Maturity	Amount	Risk Spread	Basis	Risk	Trigger
Amlin	**Tramline Re II Ltd. - Series 2013-1**	27-Jun-13	5-Jul-17	$75	3.25%	Occ	US & Canada Quake	PCS
Munich Re	**Queen Street VIII Re Limited**	26-Jun-13	8-Jun-16	75	6.50%	Occ	US Wind & Australia Cyclone	Multiple Non-Indemnity
Assurant	**Ibis Re II Ltd. Series 2013-1 (CL A)**	26-Jun-13	25-Jun-16	110	4.00%	Occ	US Wind	Verisk Index
Assurant	**Ibis Re II Ltd. Series 2013-1 (CL B)**	26-Jun-13	25-Jun-16	35	4.50%	Occ	US Wind	Verisk Index
Assurant	**Ibis Re II Ltd. Series 2013-1 (CL C)**	26-Jun-13	25-Jun-16	40	8.00%	Occ	US Wind	Verisk Index
USAA	**Residential Re 2013-1 Limited (CL 3)**	31-May-13	6-Jun-17	95	9.25%	Occ	US Wind & Quake	Indemnity
USAA	**Residential Re 2013-1 Limited (CL 11)**	31-May-13	6-Jun-17	205	8.00%	Agg	US Wind & Quake	Indemnity
Allianz	**Blue Danube II Ltd. Series 2013-1**	22-May-13	23-May-16	175	4.25%	Occ	US Wind & Quake, Mex. & Carib. Wind, Canada Quake	Multiple Non-Indemnity
Travelers	**Long Point Re III Ltd. Series 2013-1**	16-May-13	18-May-16	300	4.00%	Occ	US Wind (NE Only)	Indemnity
American Coastal Ins.	**Armor Re Ltd. Series 2013-1**	14-May-13	14-May-14	183	4.25%	Occ	US Wind (FL Only)	Indemnity
LA Citizens	**Pelican Re Ltd. Series 2013 -1**	8-May-13	15-May-17	140	6.00%	Occ	US Wind (LA Only)	Indemnity
Allstate	**Sanders Re Ltd. 2013-1 (CL A)**	3-May-13	5-May-17	200	3.50%	Occ	US Wind & Quake	PCS
Allstate	**Sanders Re Ltd. 2013-1 (CL B)**	3-May-13	5-May-17	150	4.00%	Occ	US Wind & Quake	PCS
TCIP	**Bosphorus I Re Ltd. Series 2013-1**	25-Apr-13	3-May-16	400	2.50%	Occ	Turkish Quake	Parametric Index
			Total(a):	**$2,183**				

The first issuance of the quarter was Bosphorus I Re, sponsored by the Turkish Catastrophe Insurance Pool (TCIP), which secured $400 million of coverage for Turkish earthquakes. The bond quadrupled in size from an initially proposed $100 million and provides protection on a per occurrence basis. The bond had a parametric event index trigger based on spectral acceleration recorded throughout the coverage area. The bond priced with a coupon of 2.50% compared to initial guidance of 2.75% - 3.25%.

Allstate returned to the capital markets in Q2, through a newly established Bermuda special purpose reinsurer. Sanders Re secured $350 million of per occurrence protection against U.S. hurricane and earthquake, issued through two tranches of notes. The bonds employ an index trigger based on state-weighted personal and automobile losses, derived from PCS loss reports. For the peril of U.S. hurricane, the states of Florida and New Jersey were excluded. The Class A notes priced at 3.50%, below initial guidance of 3.75% - 4.75% and the Class B notes priced at 4.00%, also below the proposed initial guidance of 4.25% - 5.00%.

Source: WCMA Transaction Database as of 6/30/2013.

(a) Q2 2013 issuance summary excludes bonds priced and marketed in Q1 2013, but issued in early Q2 2013; including Caelus Re 2013-2, Tar Heel Re and Merna Re IV. Inclusive of these issuances, Q2 total issuance would have been $3,303 million.

Q2 2013 Cat Bond Market Issuance Overview

Non-Life Cat Bond Issuance by Quarter (2009 – Q2 2013)

($ in millions)

	2009	2010	2011	2012	2013
Q1	$575	$300	$1,015	$1,343	$1,640 [(a)]
Q2	$810	$2,300	$592	$2,095	$2,183 [(a)]
Q3	$413	$230	$676	$525	
Q4	$1,602	$2,019	$1,989	$1,889	

Capacity Issued and Outstanding by Year

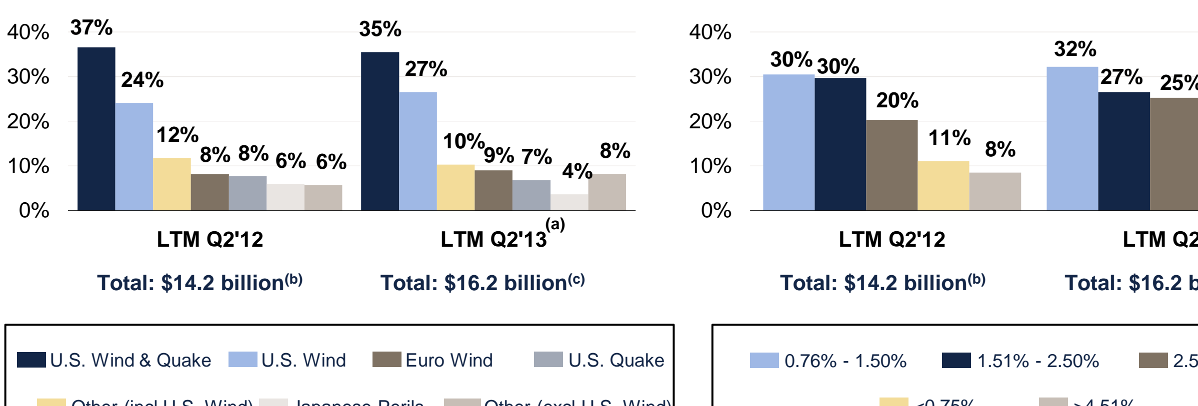
($ in billions)

	Issued Capacity	Outstanding at YE
2003	$1.4	$3.6
2004	$1.1	$3.7
2005	$2.1	$5.0
2006	$4.6	$8.4
2007	$7.2	$14.1
2008	$2.7	$11.8
2009	$3.4	$12.3
2010	$4.8	$12.4
2011	$4.3	$12.7
2012	$5.9	$15.2
2013 YTD	$3.8	$16.2

Issued Capacity / Capacity Outstanding; Number of Deals (▲ # Deals)

Par Outstanding by Risk Peril

Par Outstanding by Expected Loss



Source: WCMA Transaction Database as of 6/30/2013.

(a) Q2 2013 issuance summary excludes bonds priced and marketed in Q1 2013, but issued in early Q2 2013; including Caelus Re 2013-2, Tar Heel Re and Merna Re IV. Inclusive of these issuances, Q2 total issuance would have been $3,303 million.

(b) In aggregate, 73% of all capacity outstanding exposed to U.S. Wind.

(c) In aggregate, 72% of all capacity outstanding exposed to U.S. Wind.

Q2 2013 Cat Bond Market Issuance Overview (Continued)

Louisiana Citizens Q2 issuance, Pelican Re 2013-1 secured $140 million of per occurrence coverage for hurricanes impacting the State of Louisiana. It is a four year bond with an option to drop down to a lower layer. The coupon spread of the drop down is 9.25%. The bond priced below the initial guidance of 7.00% - 7.50% at 6.00%.

American Coastal Insurance Company (ACIC)'s Amor Re provided $183 million of one year, fully collateralized protection against named storms within Florida. The structure features an indemnity trigger on a per occurrence basis. Investors welcomed the transaction, which was substantially oversubscribed, leading to the deal being upsized from $125 million to $183 million. The deal priced at a spread of 4.25%, which was below the initial guidance range of 4.75% to 5.50%.

Travelers' Long Point Re III, which also launched in Q2, is a $300 million callable bond covering U.S. hurricanes in the northeast. The call option allows Travelers to redeem the cat bond early, by paying an early redemption penalty (a pre-defined percentage of the outstanding principal). A unique feature of this issuance was the incorporation of a variable reset. This allows the sponsor to adjust the trigger amount (and subsequently the layer attachment) as long as the expected loss for the layer remains between 1.00% and 1.50%. The bond was upsized from an initial size of $150 million due to strong investor demand. The three year per occurrence bond utilized an indemnity trigger with an initial attachment of $1.25 billion. The bond priced at 4.00%, the low end of the initial guidance of 4.00% - 4.75%.

Allianz (specifically Allianz Argos) announced its sponsorship of Blue Danube II in May. It is a multi-peril, multi-territory bond securing three years of per occurrence coverage for named storms and earthquakes in the U.S., Canada, Caribbean and Mexico. The bond utilized two triggers, a Modeled Industry Trigger Transaction (MITT) trigger for named storms (in the U.S.) and earthquake, and a standard PCS industry loss trigger, also for named storms within a specific geographic covered area (Mexico and other Caribbean countries). Allianz secured a total $175 million of protection which was up from an initial $150 million. The bond priced with a spread of 4.25%, well below an initial guidance of 4.75% - 5.50%.

True to form, USAA returned to market with their well established Residential Re franchise. The issuance was comprised of two classes of notes, the Class 3 notes and the Class 11 notes. The Class 3 notes secured $95 million of per occurrence coverage against U.S. wind (including tropical cyclone, hurricane, severe thunderstorm and winter storm) and quake (including fire following). The notes priced at 9.25%, which was below the initial guidance of 9.75% - 10.50%. The Class 11 notes, secured $205 million (upsized from an initial size of $155 million) on an annual aggregate basis, against the same perils as the Class 3 notes. The notes priced at a spread of 8.00% versus initially indicated guidance of 8.50% - 9.50%.

Assurant secured $185 million of per occurrence coverage against the peril of U.S. hurricane across specific wind exposed states and Puerto Rico. Indeed, Ibis Re II provides three years of coverage with the bond incorporating a county weighted index trigger. The Class A notes were upsized by $10 million to $110 million and priced at 4.00% (at the top of initial guidance of 3.50% - 4.00%). The Class B notes ($35 million) priced at 4.50% (initial guidance was 4.50% - 5.25%) and the Class C notes ($40 million) priced at 8.00%, at bottom end of initial guidance (8.00% - 8.75%).

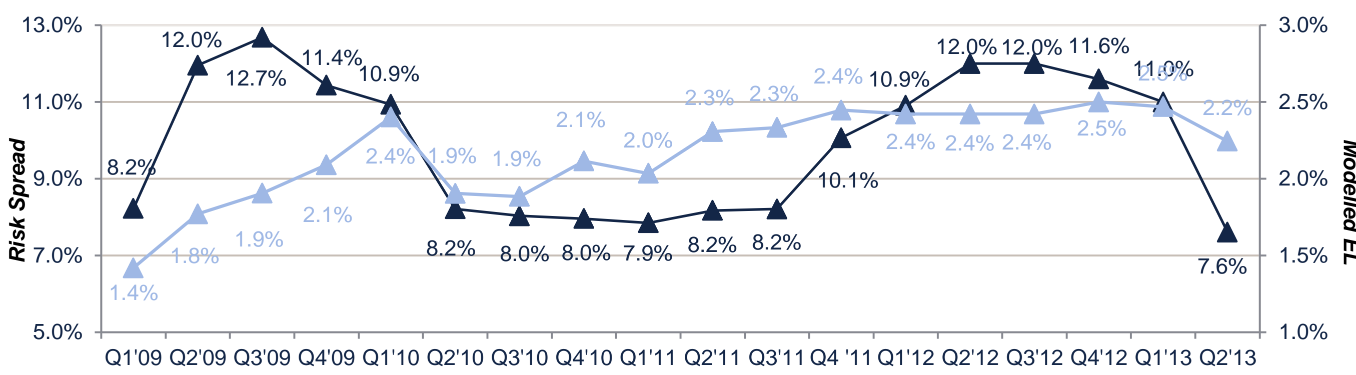
With Queen Street VIII, Munich Re obtained three years of coverage against U.S. hurricanes and Australian cyclones. It secured $75 million of coverage via two per occurrence triggers. For U.S. hurricanes, Queen Street VIII carries a county and line of business weighted PCS index trigger (similar to the Queen Street VII issuance), while for Australian cyclones it uses a modeled loss trigger. The bond priced with a spread of 6.50% compared with an initial guidance of 6.75% - 7.50%.

Amlin sponsored the $75 million Tramline Re II issuance, which was issued through a newly established Bermuda special purpose vehicle. The bond secured four years of fully collateralized reinsurance coverage against U.S. and Canadian earthquakes. The bond utilizes a state and province weighted PCS index on a per occurrence basis. The issue priced at the bottom end of initial guidance of 3.25% - 3.75%.

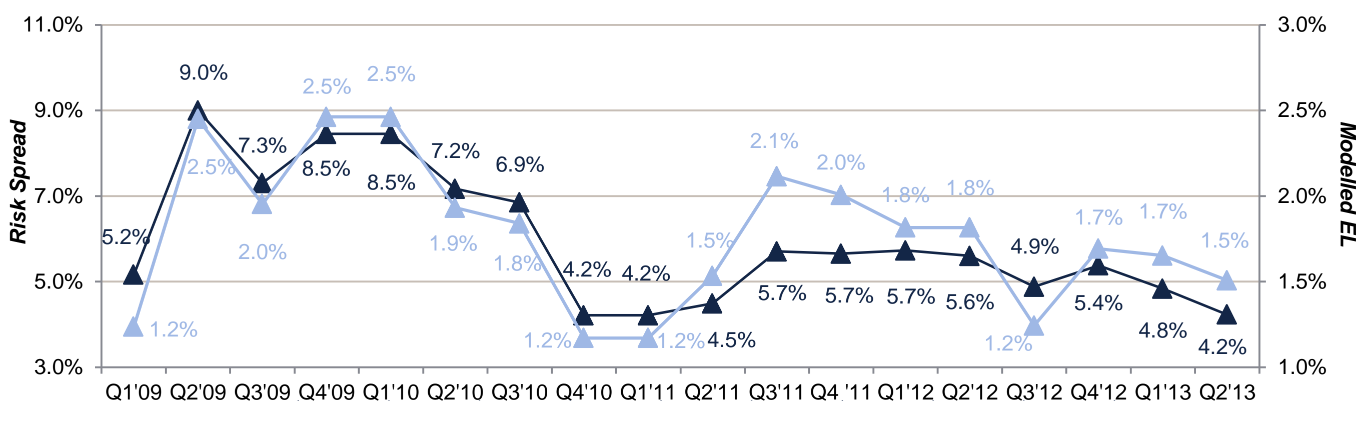
Source: WCMA Transaction Database as of 6/30/2013.

Q2 2013 Cat Bond Market Issuance Overview (Continued)

Quarterly LTM U.S. Wind Exposed Weighted Average Risk Premium & Expected Loss

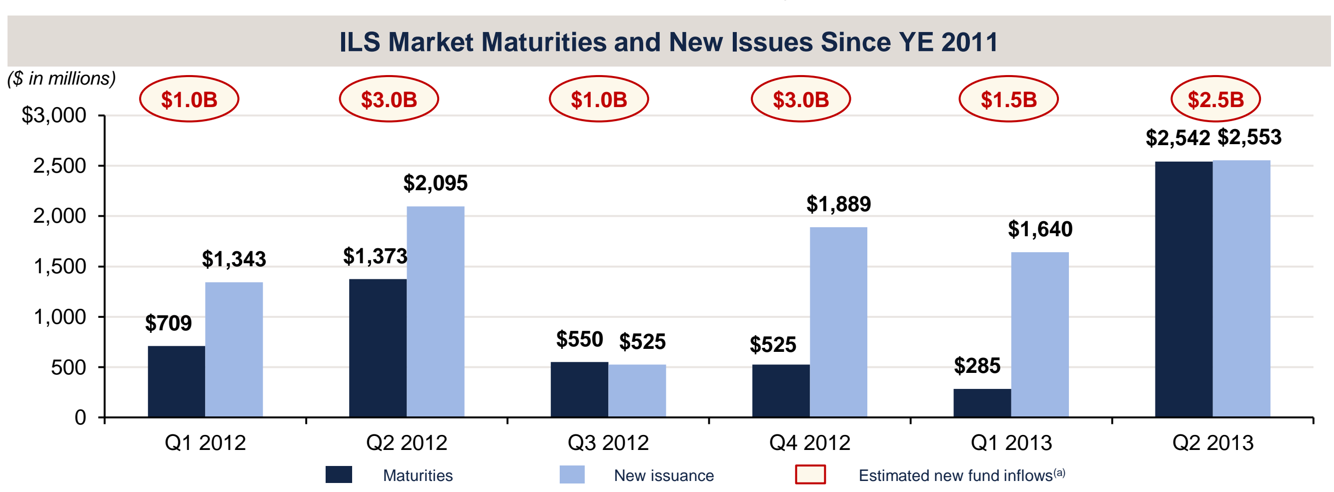


Quarterly LTM Non-U.S. Wind Exposed Weighted Average Risk Premium & Expected Loss



Source: WCMA Transaction Database as of 6/30/2013.
LTM = Last twelve months. Data is for primary issuance and does not reflect secondary trading.

ILS Market Maturities and New Issues Since YE 2011



Source: Per WCMA transaction database.
(a) WCMA estimate of new capacity for cat bonds, collateralized re and ILWs.

Cat Bond Secondary Market Trading

The second quarter of 2013 saw a robust primary issuance schedule, with a total of 14 new tranches, issued through 10 deals. This capacity gave investors plenty of choice in terms of which bonds to buy, as well as an opportunity to rebalance their portfolios. The increase in secondary market liquidity was tangible as investors sought to sell-off parts of their existing portfolios and make room for the new issues.

The quarter started with strong bids favoring sellers, but towards the middle of the quarter, buyers increasingly tested sellers by holding their bids constant and waiting for them to get hit. This strategy worked and Q2 finished with some sellers hitting down on lower bids. This all constituted a material shift in trading from the prior quarter, which was marked by quick transactions on most offers.

With signs that a healthy balance of supply and demand has returned to the market, it appears that spreads will likely stabilize going forward and be informed by seasonality. Diversifiers were actively traded with a nice bid tone for European wind and quake bonds this quarter and this could be a trend to look out for in the coming months.

Overall, investors finished the quarter feeling tested. The soft market brought new issuance with innovative features and investors had to decide whether to buy into these new issues, hold on to their existing bonds or find risk through other means. Most investors have been scrambling to take tally of how new issuance fits into their evolving portfolio strategies. As we head into wind season, we expect portfolio adjustment to continue.

YTD 2013 Sidecar Overview

The sidecar market has been gaining momentum this year, with 7 sidecars announced to date with an estimated capacity of over $1 billion. We may not yet be scaling the heights of 2006 (circa $3.3 billion capital issued), but relative to the $1.7 - $2.0 billion issued in the whole of last year the market appears to be growing. Sponsors are a mix of repeat issuers such as RenaissanceRe (Upsilon II) & Validus (AlphaCat Re) and new sponsors such as ACE (Altair Re) and Argo (Harambee Re I). Beyond those listed below, a number of private sidecars have provided substantial additional capacity.

The wider ILS market has seen a plethora of vehicles evolve to transfer risk in recent years, and the sidecar market has maintained a key role in allowing reinsurers to match profitable underwriters with third-party capital. Sidecars can be of significant benefit to sponsors by generating fee income, freeing up capacity effectively and avoiding the book value dilution of equity issuance. Nowadays, rates may not be at post-Katrina highs, but sidecars are profitable, sometimes leveraged and increasingly perceived as a big “tick in the box” to prospective shareholders in search of innovative investments in the reinsurance field. Interestingly, where disclosed, many recent vehicle launches have had significant sponsor commitment, as carriers look to attract investors in the future and build out their third-party capital franchises.

Today’s sidecars are split into two camps in terms of duration of vehicle capital base. On the one hand, there are the recent opportunistic sidecars, such as those listed below, which are short term in nature. On the other hand, permanent sidecars have also developed into a mainstay of the market. Indeed, RenaissanceRe’s permanent sidecar vehicles (such as DaVinci Re and Top Layer Re) complement its opportunistic vehicles (such as the recent Upsilon Re) as part of the company’s wider third-party capital strategy. RenRe’s sidecars continue to generate significant fees relative to the Company’s premium, and are a fundamental part of the Company’s premium trading multiple.

In today’s market, sponsors employ varying combinations of financial and operational leverage to deliver a range of attractive targeted returns for investors. The debt leverage (typically 70%) used in the post-Katrina period to enhance sidecar returns, which largely dried up during the credit crisis, is on the way back. Meanwhile, sponsors are also able to take the tail risk on vehicles, as in the case of Lorenz Re and Harambee Re, and thereby some boost returns “operationally”.

Vehicle	Kiskadee Re	Altair Re	Lorenz Re	Mt. Logan Re	Upsilon II	AlphaCat Re 2013	Harambee Re I	Lancashire Saltire I
Industry Sponsor:	HISCOX	ACE	PartnerRe	EVEREST	RenaissanceRe	VALIDUS GROUP	ARGO GROUP	lancashire
Est. Total Capital Targeted:	N/A	$95 million	$75 million	$250 million	N/A [(a)]	$230 million	N/A	$250 million
Description:	N/A	Collateralized Reinsurance	N/A	Collateralized Reinsurance	Collateralized Retro / Reinsurance	Collateralized Reinsurance	Collateralized Reinsurance and Insurance	Collateralized Retro / Reinsurance
Announcement Date:	Jun-13	Apr-13	Mar-13	Jan-13	Jan-13	Jan-13	Jan-13	Nov-12

(a) No capital disclosures but wrote a limit of $185 million.

WCMA Interview: Luca Albertini

Luca Albertini is the Chief Executive Officer of Leadenhall Capital Partners LLP.

First of all, congratulations on your recent Investor of the Year Award at the Trading Risk awards. You have grown your fund from $100 million fund to $1.4 billion within the last three years, what do you put this success down to?

Thank you. First of all we believe we have a very strong pool of talent in the company with experience in both reinsurance and capital markets. In addition we have a strong partnership with a leading reinsurer. Working with Amlin provides us with a vast pool of underwriting skills; it allows us to share our thoughts, technical expertise and ultimately transactions with a traditional reinsurer. It is quite unique, for example, for an ILS fund manager to be able to discuss, underwriting and claims paying track record or contract wordings with traditional underwriters, constantly exposed to a vast range of opportunities across layers. We have always believed that in order to invest in indemnity risk, we need to be able to offer to investors access to a “know how” comparable with that of a reinsurance company. Also, our investors endorse the quality of our approach pointing to our performance in some testing years for insurance losses. We do not know everyone else’s performance, but our investors normally do. Finally, our broad product offering ranging from non-life to life insurance-linked strategies has supported our growth as it targets different investor needs.

In 2012, you launched a fund entirely dedicated to the life mortality space. How important has your life offering been to your business?

Yes, it has been key. We have invested in the life side of our business since inception, and that has allowed us to grow in a diversified way, which our investors like as it stabilizes the sources of income of our management company. The dedicated fund is a natural extension of this and is one of the three Leadenhall strategies active in the life space. The investor base in our life strategies is mainly pension funds. In our mortality investments, they see an uncorrelated source of income with a directional risk profile, which is opposed to the risk profile of pension fund liabilities. Leadenhall’s three life strategies today represent almost 50% of Leadenhall AUM.

Just how durable is capital we are seeing entering ILS?

Many investors demand alternative investments that are non-correlated to credit and / or equities, and so there is scope to continue growing. Currently insurance risks are not only a diversifier in an investment portfolio but are also considered as yielding a premium over non-diversifiers. Whilst the premium is justified for “novelty” products, as insurance is becoming more and more mainstream, it is no longer necessary and so I believe that the bulk of the investors will maintain their allocations even when non-diversifiers will rebound and offer equal or better yields. In addition, whilst before 2008 hedge funds were an important source of capital, now the majority of investors seem to be pension funds, which is a more stable capital base as it makes strategic allocation decisions as opposed to opportunistic ones. I am hearing less and less, the classic chime of investors who want to deploy just after the big event, and then exit the space a year or two later. However, it is crucial that the capital is well invested. We need to think how quickly the money came in, and realise that it can leave just as quickly if big mistakes are made. The moment that capital markets’ capital is viewed as the cheap capital to the insurance world, then it’s the stability may be called into question. It is up to the entire ILS community to ensure that capital markets investors are treated with professionalism and respect. Reports that capital markets investors are taking terms which a professional reinsurer would not take, or pricing which is below what a professional reinsurer would accept based on its risk assessment (rather than just its ROE requirements) could lead to instability to this important capital base for the industry.

With some ILS fund closures recently, set against the continuing inflows of pension fund capital into ILS, do you believe that the industry has large enough risk pool to match the demand for products?

The capital markets are still operating in a very small percentage of the world non-life industry. If global ILS capital funds are $50 billion now, it means we still have well over $250 billion to go until we are saturated. At present ILS certainly does have constraints, and often these are structural and based on the criteria we are given by our investors. If an investor wants to generate a 10% return today they will need a somewhat different risk profile today relative to a year ago.

Note: Luca Albertini is the CEO of Leadenhall Capital Partners LLP and is not affiliated with Willis Capital Markets & Advisory or its affiliates. The views expressed herein by Mr. Albertini are his personally and do not reflect the views of Leadenhall or Willis Capital Markets & Advisory or its affiliates.

WCMA Interview (Continued)

That said, you can still grow by matching the risk and return expectations of investors and protection buyers. In Q1 this year we have seen transactions with spreads below 3.00%, which I wouldn't have seen as possible two years ago. However the capital markets found a way to meet the pricing of the traditional markets in diversifying perils and, sure enough, $400 million was invested in a sub-3.00% issuance. A more general point here is that the insurance markets need to keep challenging vast pots of uninsured risk. Outside of U.S. risks, there is a clearly large scope for a greater pool of risks to be tapped by the capital markets. The biggest constraints to growth here has been the very low pricing offered by traditional reinsurance players, the fact that some protection buyers are used to facing traditional reinsurers and do not see the advantage to learn a new way of trading risks, and the reliance on modeling by some capital markets players. This reliance clashes with the amount of risk modeled to capital markets standards outside of the U.S. With that said, every year we see innovation and expansion. New risks are coming to the market, new issuers and protection buyers are making the steps necessary to have a direct dialogue with capital markets players, and the variety of risk layers and regional scope in the ILS transaction pool has expanded. This is all is very promising for further capital markets growth.

How do you think about the relative attractiveness of collateralized re and bonds?

As a fund we are agnostic to the form of our transactions. We can invest in both, and will favor the deal which gives the higher yield. Some market participants will take lower yield for increased liquidity. However, our funds do not have monthly liquidity and, as such, we don't have to pay for it. However, if the risk and return profiles are comparable, we do favor the liquidity and transparency offered by bonds.

Today 25.00% of our book is in cat bonds. That percentage was higher in 2009, when we had almost 100% cat bonds, but that was because bond yields were so favorable due to a market dislocation post-Lehman. The collateralized market has also allowed us to build a more diversified book away from U.S. wind and quake, and has also allowed us to regionalize our peak peril exposure.

How do you see the different ways that reinsurers are operating in the ILS space?

Clearly reinsurers have operated in the capital markets in a number of different ways in recent years; they have bought protection, they have sold protection and they have lent their expertise to third parties in exchange for fee income. The latter is an increasing trend, as the industry has accepted that this capital is here to stay and has sought an active role in its deployment. In seeking out fee income, some reinsurers have involved themselves in arranging trades, other have shared their books via the sidecar structure, while the third fee model is to be involved in open-ended insurance linked funds. Some reinsurers do all and some do one or two.

A distinguishing feature of reinsurer involvement in insurance linked funds, is around the level of interaction when making decisions. Is the asset manager a standalone investment on behalf of the reinsurer, or can he call on the expertise of the reinsurer when making decisions? I do believe that being able to have a dialogue on individual investments has suited the growth in business coming to the market in indemnity form.

Recent WCMA research has shown that a 0.50% asset allocation of global pension fund assets to ILS, would see the estimated $35 to $50 billion market grow to $150 billion. Do you see this level of penetration as realistic?

Yes, that is possible. Above all, ILS must continue to innovate and produce products so that capital can structure itself around pricing and risk profiles which are palatable to the protection buyers. On one side the capital markets should continue to look at products that tap the vast amount of uninsured risks or the retention of primary carriers. On the other hand the ILS market needs to keep on converging its offering to the need of the protection buyers.

One of the clear advances made by capital markets investors has been their availability to absorb a larger proportion of indemnity triggers, so that new protection buyers approaching the capital markets do not need to take basis risk into account. Also some risk of the new capital reaching the market has been available to cover very remote risks at a low rate on line, which up to a few years (or even months) ago were deemed to be below the minimum spread acceptable to capital markets players.

Diversifying non-life perils have been placed at a spread below 3.00% and some very remote Florida risk has been placed with the capital markets just above 4.00%. This shows that some of the capital markets capital has come to market with risk and return profiles which are in line with the one demanded by traditional protection buyers.

In summary, with the investors requirements meeting the protection buyer needs, and with investors and capital markets players being innovative in creating extra protection products which complement the traditional markets, we may well be one day 2-3 times the current size. There are two main threats to this growth: 1) surprises (i.e. losses which are not in line with what the marketing effort showed being in the range of the possibilities) and 2) the investor community not maintaining pricing discipline and being recognised as the cheap source of capacity which is arbitraged by the reinsurance community.

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