

# Capital and Financing: Woof!

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The expectation of claims in professional indemnity and credit lines might finally be materialising. BRAVE Partners believes that this is the right time for an insurer to take good quality financial risks and examines some of the reasons why insurers might be shying away. This leaves the door wide open for private capital.

In the commentary [Barking](#), BRAVE Partners recalled the classic sketch in the cult Peter Sellers comedy The Pink Panther where Inspector Clouseau asks the hotelier: "Does your dog bite?" As the hotelier shakes his head, Sellers crouches down to pet the dog who immediately attacks, biting his hand. Turning to the hotelier Sellers accuses: "I thought you said that your dog does not bite". "Zat is not my dog" responds the hotelier.

In 2008 and 2009, the insurance markets expected large losses in D&O and credit insurance lines. By the end of 2009, both were both viewed as the dog that did not bite – there were no claims. The first quarter of 2010 is showing that the dog does bite and the market is starting to discover whose dog it is.

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## Barking

Over the past weeks a number of sources, including the excellent Insurance Insider, have been reporting losses from credit risks. More recently The Insurance Insider has reported that: "HCC sees more D&O subprime claims in 'challenging' operating conditions". Headlines that interest the firm, such as these are all tracked on the [website](#). There is not just intense baking, but also the odd bite, such as: "Axis takes Q4 hit for Blue City credit loss".

## The rush of capital

Recent financial market events have been at least the equivalent of a large hurricane striking a densely populated area. Insurance risks, and within that natural catastrophe risks in particular, are usually measured in terms of their "return period". A return period is the number of years over which an insurance company needs to collect premiums in order to break even on the loss. Naturally, actual premiums are higher than the return period. Large hurricanes will have a return period of 100 years or more. In the case of the recent financial market events, we could say that this is an 80 year return period since recent conditions are viewed as the worst since the great depression which commenced around 1929.

## Financial risks

Financial risks markets have just experienced an 80 year loss event. If that were the property catastrophe markets, BRAVE Partners would expect to see capital flow to the market. Currently the exact opposite appears to be happening in markets for financial risks. Insurers are cutting back on capacity and even exiting the market. The exodus began with the less committed participants, such as XL Capital, but has moved on through all of the stalwarts, including Brit and QBE. In residual value insurance RVI Group is just about the only remaining market and that's probably because they don't do anything else!

## Why fly?

The BRAVE Partners have been trying to work out why capital is fleeing from the financial risks insurance markets, rather than embracing what looks like an opportunity. The firm has had many discussions on the topic, including attending a meeting on the future of residual value insurance, organised by the firm's good friends at Jardine Lloyd Thompson (JLT). Two main issues, that make sense to the BRAVE partners emerge from these discussions.

- Asset risks are not seen as core insurance business and therefore insurance company investors are perturbed by large losses from these lines of business. If there is a major earthquake, insurance company investors expect their firm to have losses. They do not expect the same from a large decline in ship values.
- It is hard to predict the end of a financial crisis. It is much easier to predict the end of a hurricane or the end of an earthquake. This is correct and in fact BRAVE Partners thanks the wise head that made this observation. However, this is not as true as it might seem. The 2004 and 2005 hurricane seasons show that just because one hurricane year has been active the next will not be. Property catastrophe exposed firms did lose in both years and some lost badly in 2005 by allocating increased capital into the harder market almost on the assumption that the hurricane season must be benign. The reinsurance industry always jokes that the 100 year event seems to happen every other year.

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## The opportunity

BRAVE Partners believes that there is a significant opportunity to step into a void created in the financial risks insurance market. The firm believes that this opportunity is best filled by a financially orientated fund with the expertise to understand assets, asset risk and asset finance. The capital is best provided from private sources and not through public vehicles. This is not for any need for secrecy, but rather to ensure that management can focus on running the business with far more knowledgeable and focused investors than a broad shareholder and analyst base of a public company.

## Reasons to be cheerful: part 3

Physical assets are the new black. BRAVE Partners notes with interest that Allianz, one of the world's largest insurance companies – and therefore a large pool of capital – has recently announced that it is reducing its investments in stocks and bonds and increasing its direct investments into infrastructure and projects. The Bloomberg article gave parking meters in Chicago and windfarms as two examples. Done well, a lot of financial risks insurance also relates directly to physical assets. In particular residual value insurance requires the physical asset to be delivered before a claim is paid.

The beauty of physical assets is that it is usually possible to work out which ones are really needed and if you are the owner of a physical asset that someone needs – that is a good place to be.

## BRAVE Partners services

BRAVE Partners is working with a number of parties with a view to delivering capital to, what the firm believes is, an outstanding opportunity in financial risks. These risks must be well selected and well underwritten – the BRAVE Partners' mantra is capital AND EXPERTISE. However, the firm does believe that there is a clear and present opportunity. BRAVE Partners is actively seeking both business plans and interested investors.

## Interaction

If you enjoyed this commentary and would like to receive a weekly update by E-Mail, then please contact BRAVE Partners on [commentary@bravepartners.com](mailto:commentary@bravepartners.com)

If you would like to comment on the content of this piece, then please send an E-Mail to [discussions@bravepartners.com](mailto:discussions@bravepartners.com)

- BRAVE Partners LLP believes that there is a significant opportunity to provide capital to a diversified financial risks insurance business.
- BRAVE Partners is actively seeking both business plans and investors for a diversified financial risks insurance business.

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