

Insurance linked securities: Cat-bond-atrophy

Thomson Reuters reports the cat bond investors are demanding more detailed data before investing. The surprise to BRAVE Partners is that it has taken this long. The firm has long espoused that a seasoned underwriter is an essential ingredient when investing in insurance risks.

February 6, 2010

Underwriting

The highly entertaining stock pundit Jim Cramer runs a great show on CNBC in the USA. The show is targeted at educating retail investors and Cramer's mantra is about doing your homework before buying a stock – and in fact while you own it – so that you also know when to sell.

The insurance linked securities market has always struck BRAVE Partners as an avenue for investors to take insurance risks without the knowledge and homework of a seasoned underwriter. In the view of the firm this is a sure method to lose money – especially in a market that is driven by brokers who are expert in finding naïve capacity. Successful underwriting is about knowledge, detail and knowing to whom and when you say no.

Cat bonds

A cat bond can offer many risks. Some are parametric – that is they trigger on a certain size and geography of a loss. Investors sign up to these based on the report produced by one of the accepted modeling companies (RMS, AIR and EQECAT). Modelling has certainly improved underwriting and it is an invaluable tool, but all modeling has limitations. It is essential to understand the strengths, weaknesses and – most important – limitations of any model.

Broker!

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On a similar note, BRAVE partner Christopher Cloke-Browne vividly recalls a proprietary credit trader proudly telling him that he had just bought a great bond; Avalon Re.

Avalon Re

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The trader was a smart guy with an engineering background, but he had definitely drunk the Kool Aid dished out by the broker. The bond was exposed to “events”. An “event” transpired to be a claim of over \$150m, which sounds like a large number. However when you understand that Avalon Re was sponsored by OIL Casualty Insurance Limited (OCIL) and that \$150m was effectively a liability claim against any of the largest global oil and chemical companies – “events” all of a sudden did not seem so remote. A good underwriter would know that and not fall for the stories about not being exposed if an oil rig catches fire – unless there is a huge spill etc... True, the physical damage to the rig would be covered by a property policy; however all the injury, distress, pollution, etc... would go to OCIL. Paragraph two of insurance 101 says: casualty insurance tends to produce higher losses than property insurance.

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So what for investors?

BRAVE Partners is a strong advocate of the investment benefits of insurance risks. However, the firm’s mantra is that investors need a Sherpa when investing in the insurance markets. The markets are shark infested. That Sherpa is a good, seasoned, cynical underwriter.

In practical terms, what this means is don’t invest in cat bonds no matter how much information that is released with them or not. The BRAVE Partners approach to investing in insurance risks is to identify a good underwriting team in an attractive line of business and then back their traditional business. This can be done by direct investment

in start up companies, or by a fund style investment where the fund is used to collateralise traditional insurance business written by a dedicated reinsurer. Both approaches are tried and tested and shown to work well.

Investors seem agree with the BRAVE Partners approach. Hedge fund and private equity money is increasingly seen in Lloyds and the Bermuda and Swiss markets are popular destinations for specialist start ups.

BRAVE Partners services

BRAVE Partners advise investors on the strategies for accessing investments in insurance risks, and the optimal markets in which to apply them.

Interaction

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- *A careless, uninformed investor in insurance risks is almost certain to be exposed to losses.*
- *BRAVE Partners can identify the right opportunities, people and structures for investors to make successful investments in insurance risks.*

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