The Growing Importance of Alternative Capital in the Commercial Insurance Market

The world today looks very different than it did five or 10 years ago. How we invest, conduct business transactions, think about risk — has changed. Over the past decade, the US stock market has been trending upwards, with occasional market corrections. But 2008's recession has had lingering effects; the appetite for risk has been diminished. Investors started looking at the insurance industry as a source of opportunity and a way to diversify to minimize exposure. They found what they were looking for — first in reinsurance and more recently in the commercial catastrophe property market.

And it is likely just the beginning. This means that alternative capital and the insurance industry could have a long relationship.

A BRIEF HISTORY

Specialized insurance-linked investments were developed in the late 1990s. These specialized funds were a big part of what became known as alternative capital. These dedicated investment funds in the reinsurance market initially purchased catastrophic (CAT) bonds. Alternative capital kept evolving and has been providing capital support for insurers via the reinsurance and retrocessionaire markets for at least 10 years. They sell balance sheet protection, enabling insurers to underwrite more policies and continue to cover risks.

The relationship that developed between reinsurance and alternative capital is a symbiotic one — the rate of return on capital that reinsurers provide and alternative capital seek is well matched. As a result, reinsurers have benefited from the influx of alternative capital into the sector.

While that benefit also helps insurance companies attain reinsurance at reasonable rates, the influx of alternative capital into the reinsurance market has not helped insureds directly. But that began to change, and we've recently seen financing solutions in the retail-direct client accessed space.

DISASTER GAP

There is a growing gap between global insurance coverage for potential catastrophes and what the claims could actually amount to following a major disaster. Dr. John Seo, co-founder of Fermat Capital, calls this the "disaster gap." It is something alternative capital solutions could possibly solve for on the global stage.

For example, imagine that you have 10 hotels and resorts around the world that sit on the beach. A couple of quiet years are followed by an increase in catastrophes. Even in a robustly capitalized property market, a marked increase in catastrophe losses along with increasing insurer combined ratios would make property insurance rate reductions more difficult to obtain. And that could impact you — making it more difficult to get 100% of your exposures covered. That's where alternative capital might be able to provide a solution.

WHAT CONSTITUTES ALTERNATIVE CAPITAL?

Traditionally, reinsurance companies incorporated several methods to develop their capital base, and alternative capital provided a portion of that funding. But it's taken on greater importance over the years. Between 2005 and 2015, the amount of alternative capital that was deployed increased from approximately $10 billion to $74 billion. It comes from a variety of sources, including:

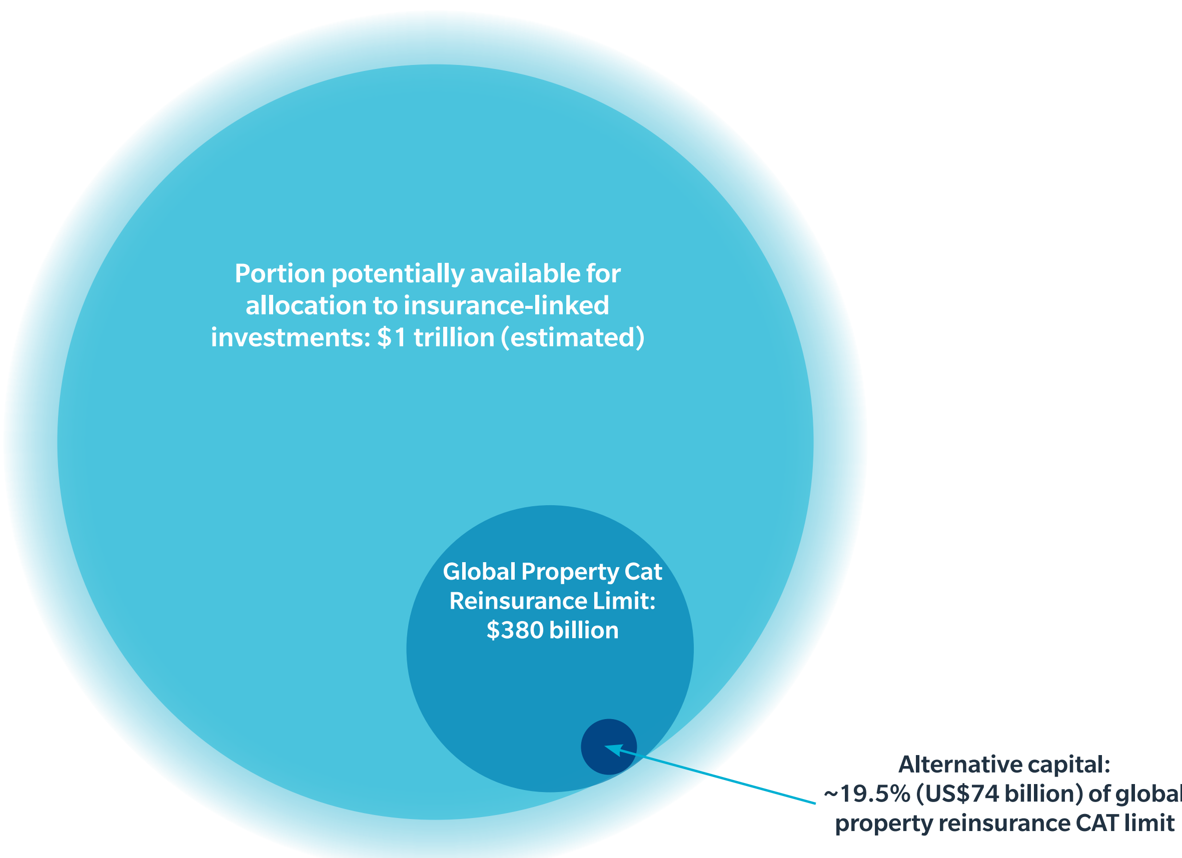
- Pension funds.
- Hedge funds.
- Mutual funds.
- Sovereign wealth funds.

Within the pension fund sector alone, there's enormous capacity and appetite for entry into the insurance market. What is different about deals from these sources is the underlying characteristic: They are considered non-correlated and can enter and exit the marketplace quickly. Insurance-linked investments can take the form of:

- Catastrophe bonds.
- Collateralized reinsurance.
- Reinsurance sidecars.
- Insurance solutions.

Currently, looking at the $35 trillion in pension fund assets alone, there is potentially $1 trillion that could be allocated to insurance-linked investments.

GLOBAL PENSION FUND ASSETS UNDER MANAGEMENT = $35 TRILLION



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SPOTLIGHT

Alternus: Automatic Retail Sourcing of Alternative Capital Offered Through The Schinnerer Group.

A program for US-domiciled clients purchasing property coverage from a diversified panel of insurers, Alternus is exclusively available to Marsh clients. It offers direct access to alternative capital markets to cover a portion of their risk and diversify their insurance portfolios.

Key highlights:

- Automatic 10% capacity share.
- Automatic 7.5% price discount (against lead pricing).
- Includes second-year capacity capability (addressing multi-year or long-term concerns).
- All risk coverage — including for critical catastrophic perils.
- Written on Allianz (S&P rated AA and A.M. Best rated A+) paper, following terms and policy wording agreed by lead commercial insurers.

For more information contact your local Marsh representative, or:

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