

REINSURANCE AND INVESTMENT FUNDS

WITH THE HURRICANE SEASON APPROACHING, NEIL HORNER AND FEDERICO CANDIOLO OF ATTRIDE-STIRLING & WOLONIECKI DISCUSS THE CONVERGENCE BETWEEN THE FUNDS AND INSURANCE INDUSTRIES AND WHY BERMUDA'S INSURANCE PROPOSITION IS SO ATTRACTIVE

Bermuda is a resilient reinsurance marketplace which continues to prosper and evolve. The recent natural catastrophes in Australia, New Zealand and Japan will entrench Bermuda's position at the helm of the convergence between the funds and insurance industries.

In the wake of major catastrophes, the market needs investor capital to rebuild. The damages caused this year by the catastrophes in New Zealand and Japan are significant, with estimated total losses in excess of \$52.6bn. With the introduction of the Special Purpose Insurance regime and other recent reforms, the Bermuda reinsurance market provides a world class, innovative framework to respond to the challenges that lie ahead.

Capital markets looking for uncorrelated asset classes have found CATCo's investment proposition to be an excellent investment opportunity.

A USEFUL PRECEDENT: 2005

Institutional investors have participated in the insurance industry to provide capital since the first CAT bonds were issued 15 years ago in 1996.

In 2005, the hurricanes Katrina, Rita and Wilma triggered a capacity crunch in the global insurance market (causing losses of around \$60bn) and occurred at a time when many of the rating agencies increased the amount of capital required to insure property coverage for catastrophe risk. This caused many reinsurers to reduce the cover they were able to offer in order to maintain their ratings. The knock-on effect to many insurers was such that they were unable to find the reinsurance contracts that were required to service their clients' needs.

The insurance markets abhor a vacuum, and the vacuum was filled by a substantial wave of Bermuda insurance carriers incorporated on the island, known as the Class of 2005. One important feature of these new start-ups was that hedge fund capital represented a significant propor-

tion of the new capital coming into the market.

2005 saw the first wave of incorporations that signalled greater convergence between the hedge funds industry and the insurance industry. In some instances, hedge funds simply took an equity stake in various Class of 2005 companies but, perhaps much more significantly, some of the hedge funds formed their own licensed Bermuda reinsurers to write property catastrophe risk and to provide coverage at the highest levels.

The role of the hedge funds in the Class of 2005 is a significant precedent. Today we can see that it was more than a passing trend. It is apparent that capital markets will continue to be an increasingly important component of the Bermuda reinsurance market in 2011.

CATCO: A SUCCESSFUL CASE OF CONVERGENCE

One clear example is that of CATCo. CATCo Investment Management is living up to the Bermuda market's reputation for innovation by introducing a whole new approach to reinsurance. The company, led by chief executive officer Tony Belisle, manages investment funds which provide the capital for CATCo Re, the organisation's Class 3 Bermuda reinsurance company,

to write fully collateralised reinsurance contracts. The company manages a range of diversified insurance-based investments.

A unique part of the company's structure is the Bermuda incorporated CATCo Reinsurance Opportunities Fund, which is listed on the London Stock Exchange's Specialist Fund Market and the Bermuda Stock Exchange. The London and Bermuda-listed entity is a Bermuda closed-ended fund that acts as a feeder fund into the Diversified Fund of CATCo Reinsurance Fund, a larger Bermuda regulated institutional fund registered as a segregated accounts company, which provides the capital for CATCo Re to write fully collateralised reinsurance contracts. CATCo Reinsurance Fund may additionally invest in products including, but not limited

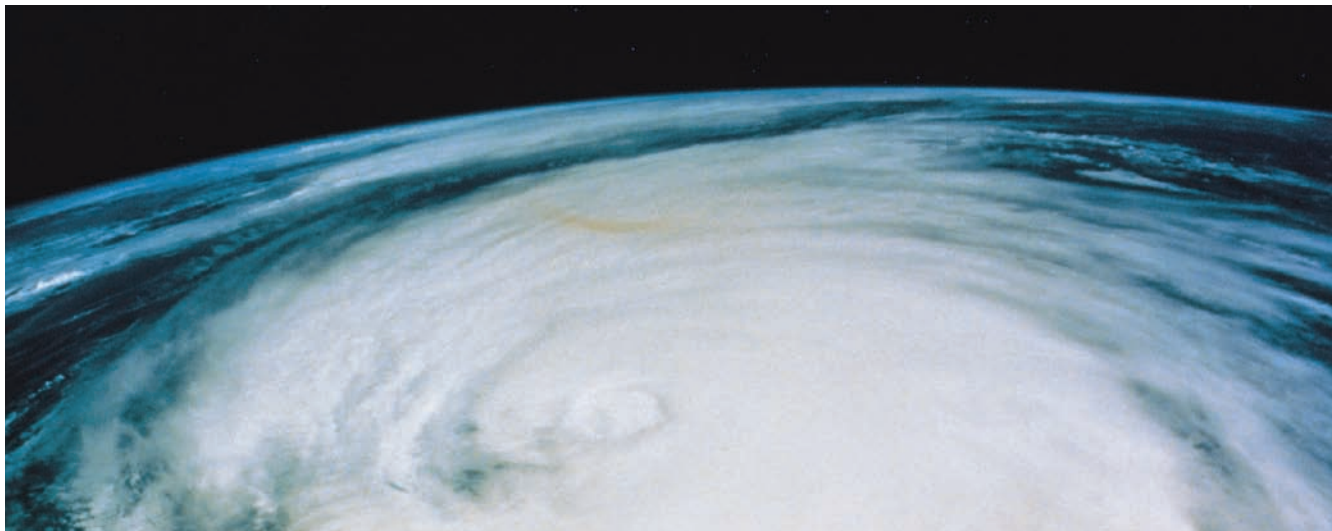
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Neil Horner is head of corporate at Attride-Stirling & Woloniecki having joined the firm in March 2003. He has extensive experience working on large commercial and corporate finance transactions. He was heavily involved in advising investors participating in the Class of 2005 start-ups.



Federico Candiolo is corporate counsel at Attride-Stirling & Woloniecki. Prior to joining ASW in Bermuda, Federico practised in the banking and corporate departments of leading firms in London and the Cayman Islands, focusing on corporate finance, investment funds and capital markets work.



to, insurance-linked securities (ILS) and insurance loss warranties (ILW).

The attractions of CATCo to institutional investors include non-correlation with stocks and bonds, diversification across risks pillars, no asset or credit risk exposure and double-digit returns. Reinsurance buyers are attracted by the fact that all of CATCo's products are fully collateralised, offer a portfolio reinsurance solution specific to the market, that is unique, and adds certainty to the company's ability to meet its obligations.

The CEO said CATCo targets returns of LIBOR plus 12-15% for its investors and offers more capital protection than direct investment in catastrophe bonds, which are tied to particular risks, such as US wind, and can erode investors' capital if event losses are sufficiently great to trigger the bond. In addition, catastrophe bonds typically yield a coupon of 5-7% pa. CATCo projected returns for 2011 are LIBOR plus 24%. Again, Bermuda provides the ideal platform to structure this proposition.

CATCo's senior management team also includes chief operating officer and chief financial officer Jason Bibb, and chief underwriting officer Graham Wood.

Bibb has some 15 years of investment management experience. He was a co-founder of the Bermuda-based Isis Fund Limited and served as director and chief operating officer of Citigroup's alternative investments division.

Wood has more than 20 years of (re)insurance experience with Lloyd's of London syndicates and brokers, including Benfield and Gallagher Re. He most recently headed up Oxygen Re's Bermuda operations.

CATCo was incorporated in Bermuda in July 2010. Bibb said the island had been an easy choice as domicile, because Bermuda is a proven, reputable business centre offering expertise and stability, not to mention its status as the reinsurance capital of the world.

Bibb said: "Certain legal advisors had suggested we should incorporate our group of companies in Guernsey. However, our legal advisors, Neil Horner and Federico Candiolo of Attride-Stirling and Woloniecki, provided us with strong practical rationale and advised why Ber-

muda could compete on every level with other jurisdictions around the world. Remember, we had the option to choose any jurisdiction.

"We decided to incorporate the closed-ended listed fund, and all of our other investment and reinsurance companies in Bermuda, and were welcomed warmly by the Bermuda Monetary Authority, the Government, and our service providers in Bermuda. We were very impressed with the time it took us to be fully licensed and operational, which is testament to the standards offered by our legal team and the Bermuda Monetary Authority."

Bibb said CATCo had brought a capital markets approach to retrocessional reinsurance, diversifying its risk exposures like an investor seeking to have a diversified portfolio of stocks and bonds. The protections offered are unique and have never been offered to the retrocessional market in the manner which we deploy our investment strategy. Furthermore, other companies have attempted to launch listed retrocessional vehicles offering differing types of investment strategies. None have launched. CATCo's listed fund is the first of its kind on the Bermuda and London Stock stock exchanges. CATCo's ambitions were not to acquire hundreds of investors or customers.

"We want to make our products a core part of their reinsurance programs and we have seen that happening already," explained Mr Bibb. "On the investor side, it's the same. On our private fund, the minimum investment is \$10m and our average investment is \$15m to \$20m. These are investors who understand this new alternative asset class and intend to invest for some time to come. Our investors are very sophisticated."

CATCo's investment funds have attracted a number of institutional investors and pension funds, including Henderson Global Investors, Co-operative Insurance Society, Baillie Gifford, J.P. Morgan Asset Management and the Qatar Insurance Company, to name a few.

CATCo is growing, with a second wave of institutional investment completed following the issuance of new C shares, only five months after the initial public offering. ■