Original Risk

How Australia and New Zealand Could Benefit from Industry Catastrophe Loss Aggregation

PCS
A Verisk Business

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Industry loss aggregation solutions provide an intuitive benefit to property-catastrophe insurance markets. There's a clear understanding that knowing 'the loss' can help with claim benchmarking, reserving, catastrophe modelling, and working with regulators. For most insurance and reinsurance company executives, though, the principal benefit of a centralised industry loss aggregation platform is risk transfer. Index-triggered protection — be it from catastrophe bonds or industry loss warranties (ILWs) — can lead to more effective risk management, optimised capital allocation, and ultimately the creation of more shareholder value.

Property Claim Services® (PCS®), a division of Verisk Insurance Solutions, currently provides loss aggregation services in the United States, Canada, and (as of 2015) Turkey. We've found that introducing industrywide loss aggregation capabilities results in salient risk and capital management advantages for an insurance market, as we saw in Canada following our 2010 launch.

The global insurance and reinsurance industry is hungry for original risk — new risks entering the global risk and capital supply chain offering opportunities for diversification. Peak peril markets, in particular, are crucial to capital providers, and they've been eyeing Australia and New Zealand for years. The only thing missing has been a credible, independent industry catastrophe loss aggregation platform.

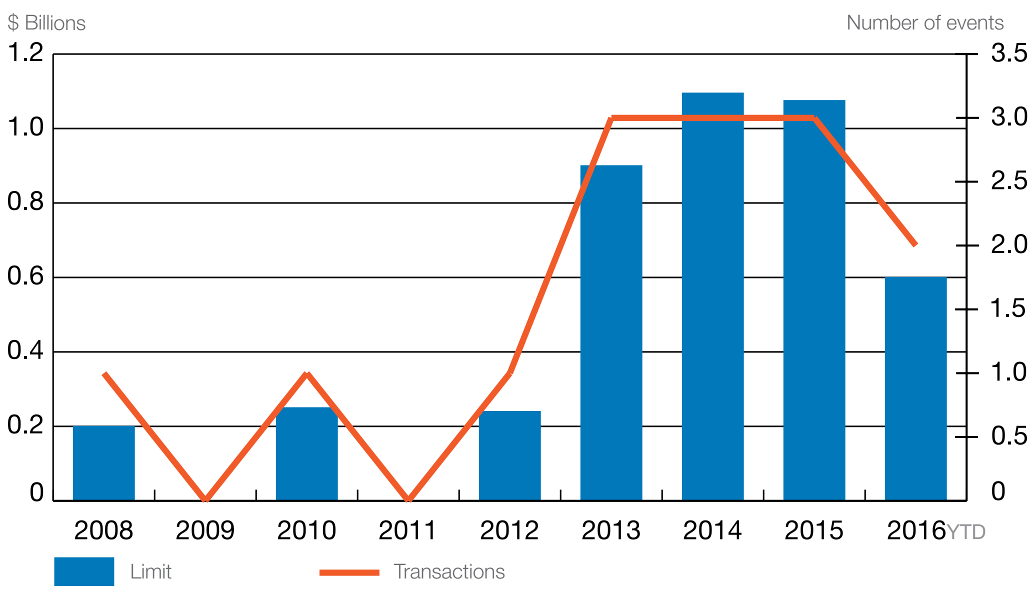
AN OVERNIGHT CHANGE

The catastrophe bond market is still relatively young, with only around 20 years of history. In that time, insurers and reinsurers (and some corporates) have completed more than 300 transactions, according to the Artemis Deal Directory, amounting to more than $75 billion in cover. The overwhelming majority of transactions provide protection for US risks, both hurricane and earthquake. However, there is investor appetite to enter new markets and take advantage of diversifying perils (such as Turkish earthquake). And, with as much as $900 billion waiting to enter a global reinsurance market of only $600 billion, the need to bring more original risk to market is palpable.

CATASTROPHE BONDS INCLUDING CANADIAN RISK

When new risk comes to market with the ability to trigger on an industry loss basis, the capital markets respond. Canada demonstrates that. Prior to the launch of PCS Canada® in 2010, only one catastrophe bond that included Canadian risk came to market — East Lane Re with $200 million in limit. Since then, 14 transactions that included Canadian risk have been completed, with aggregate notional of more than $4 billion (not limited to Canadian risk). Of the 15 transactions completed that included Canadian risk, 10 use data from PCS.

Catastrophe Bonds Including Canadian Risk



Sources: PCS, Artemis Deal Directory

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Catastrophe Bond	Limit	Issuance Year	PCS
Galileo Re	$300 M	2016	Yes
Atlas Re	$300 M	2016	Yes
Kilimanjaro Re	$625 M	2015	Yes
Atlas Re	$150 M	2015	Yes
Galileo Re	$300 M	2015	Yes
Tradewynd Re	$500 M	2014	No
Kilimanjaro Re	$500 M	2014	Yes
Riverfront Re	$95 M	2014	Yes
Tradewynd Re	$400 M	2013	No
Galileo Re	$300 M	2013	Yes
Tradewynd Re	$125 M	2013	No
Tramline Re	$75 M	2013	Yes
Blue Danube	$240 M	2012	Yes
Merna Re	$250 M	2010	No
East Lane Re	$200 M	2008	No
Total PCS Issuance	**$ 3,385 M**		
Total Issuance	**$ 4,360 M**		

Sources: PCS, Artemis Deal Directory

The introduction of a loss aggregation platform and industry loss index provides an opportunity for new sources of capital to enter a market, which comes with a number of important benefits:

- diversification of protection outside the global insurance and reinsurance system
- fully collateralised protection
- multi-year cover
- potentially lower cost of capital
- protection of intellectual property, underwriting practices, and other proprietary information

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In addition to catastrophe bonds, the use of ILWs that included Canada increased significantly following the launch of PCS Canada. Data is difficult to source, given the opacity of the ILW market, but several reinsurance brokers — representing significant market share — have indicated increased transactional activity as a result of the availability of a credible, independent industry loss aggregation solution. There has been some Canada-only ILW activity (we're also aware of this from cedants), but the more common approach is to do a regional transaction that includes both Canada and the United States.

Although the launch of PCS Turkey is still too recent to show significant market developments, early indicators are consistent with the trend that followed the launch of PCS Canada. Reinsurance brokers are already getting inquiries from cedants about the availability of the loss aggregation solution and are expressing interest in laying off risk on an industry loss index basis.

ALWAYS 'ON RISK'

The introduction of original risk into the global reinsurance and insurance-linked securities (ILS) community isn't the only reason an Australia/New Zealand industry loss index would be useful. There are catastrophe bond structuring practices that would benefit from a disciplined approach to regional loss aggregation. Specifically, the Queen Street Re series sponsored by Munich Re illustrates the case.

Consider a US-only catastrophe bond, covering both tropical storm and earthquake. Assume that it's issued with a risk period starting 1 June. For the US hurricane season (June through November), the transaction is 'on risk'. It trades in a manner consistent with being exposed to large losses that can occur frequently. After November — and until the beginning of June — tropical storm risk is minimal. So, the bond trades like it's only exposed to earthquake. The bond has only six months of peak risk.

This is where catastrophe bonds like Queen Street Re are interesting. They are always on risk. When the wind season ends in the Atlantic Ocean, it begins for the Australia/New Zealand region. The bond is always exposed to peak risk, as a result. This makes the transaction more attractive to ILS investors, potentially broadening the capacity available to insurers and reinsurers seeking protection.

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READY FOR A BITE

The global reinsurance and ILS community is ready to taste any new peak peril catastrophe risk that can come to market, and Australia and New Zealand have been a priority for some time. The only thing missing is an independent, reliable, and accurate industry loss aggregation solution. Upon implementation, it will bring more capacity, diversification of capital sources, and a range of other benefits. The market's experience in Canada shows the trend, and Turkey is already showing an adoption curve. Insurers can manage their risk and capital more effectively when they have access to independent industry loss estimates — and their shareholders benefit most.

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