

Reinsurance Sidecar Investments

Reinsurance sidecars are conventionally referred to as Sidecars. These are financial structures that have been created to allow investors to participate in the risk and return of a group of insurance policies (a "book of programs").

These are written by an insurer or reinsurer (hereafter re/insurer). They earn the risk and return that arises from that business.

A re/insurer will pay ("cede") the premiums related to a book of programs to such an entity if the investors place sufficient funds in a trust account to be pledged to ensure that it can meet claims should they arise. The liability of investors is limited to these funds. Reinsurance sidecar investments have become very prominent in the aftermath of Hurricane Katrina. They are now a vehicle for re/insurers to add risk-bearing capacity, and for investors to now participate in the potential profits resulting from re/insurance. After 9-11, an earlier and smaller generation of sidecars was created for the same purpose.

Reinsurance Precedents

Reinsurance Sidecar investment have precedents in the reinsurance industry under the name "quota-share reinsurance." In these agreements, a re/insurer cedes to the quota-share reinsurer a percentage of all the premiums resulting from a book of business. This is in exchange for the reinsurer bearing the same percentage of the liability for the losses. The quota-share reinsurer pays a ceding commission to compensate the ceding investor for their expenses. The ceding commission also includes a profit allowance which increases in proportion to the profitability of the programs. These reinsurance treaties currently provide ceding companies with the ability to write more insurance policies (more premiums) than would be possible based on their own capital. They also earn a certain amount of fee-based income (through ceding commission). This quota-share reinsurers act like an insurance wholesalers. It allows them to earn a return on capital without having to create primary insurance distribution (also know as a Fronting Company). Lloyd's of London is one such re/insurer. It "names" acts as such reinsurers, pledging the resources of investors and firms at risk in order capitalize books of business written by insurance brokers, agents and underwriters.

The Market
has grown since 9-11 and Hurricane Katrina

After 9-11, the strategy of raising funds from capital markets investors to support quota-shares arose. A handful of such ventures were created (DaVinci,

Olympus, Rockridge). These were a natural outgrowth of the development of re/insurance as an asset class and were the first true sidecars.

After Hurricane Katrina the sidecar idea became very prominent among investors. This was because it was seen as a way to participate in the risk/return of the higher-priced ("hard") reinsurance market – and without investing in existing reinsurers (who might have liabilities from the past that would undermine returns) Three such entities were up and running by year end 2005 (sidecar, capital raised, ceding re/insurer, book of business).

Flatiron, Arch Capital

Blue Ocean, Montpelier Re

Cyrus, XL Capital

These entities have been created since 2006 (sidecar, capital raised, ceding re/insurer, book of business):

GENRE, General RE owned by Warren Buffett, catastrophe reinsurance

EII,
Equity Insurance International, high margin selective niche reinsurance

Kaith/K5, Hannover Re, several lines of insurance and reinsurance

Petrel, Validus, marine and energy reinsurance

Helicon, White Mountains Re, property catastrophe reinsurance

BayPoint, Harbor Point, selected short-tailed lines of business

Timicuan/RPP, Renaissance Re, reinstatement premium protection

Starbound, Renaissance Re, Florida treaty business

Sector Re, Swiss Re, property catastrophe and aviation reinsurance

Castlepoint Re, Tower Group, program and specialty insurance

Sirocco, Lancashire Re, Gulf of Mexico offshore energy

Monte Fort Re, Flagstone Re, peak zone and ILW (industry loss warranty) coverage

MaRI, Marsh / ACE, US commercial property [1]

Concord, AIG, US commercial property business

Total
capital investment has been raised to over \$12bn as of September 2008 and had established sidecars as a major capital raising vehicle for catastrophe risk.

Reinsurance Participants

Many Lead equity investors that have been publicly disclosed. These include First Reserves, J.C. Flowers, Goldentree, Goldman Sachs, Highfields, and Farallon.

Many Investment banks – including Aon Capital Markets, Merrill Lynch, Goldman Sachs,, Morgan Stanley, Deutsche Bank and Swiss Re Capital Markets have provided advice on the creation of sidecars, usually alongside specialist consultancies Risk Management Solutions.

Also, many law firms have been active in this space. These include Wilkie Farr, Cadwalader, Conyers Dill & Pearman in Bermuda, Wickersham & Taft, Debevoise & Plimpton, and others in the US and Offshore.