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Investors frustrated by loss creep communication

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Experts at Trading Risk's London ILS Conference gave a mixed report on investor appetite and opportunities in the sector.

ILS investors were more frustrated by extended loss creep last year than by the total hit, according to Michael Knecht of Siglo Capital Advisors.

The founder of the Zurich-based firm said its clients lost around 2 percent on ILS portfolios in 2017 and were broadly flat last year.

He said the response to this was muted as investors understood the risk premium came with potential downsides. However, he warned that the sector risked losing trust.

"The last two years have been more challenging in explaining what was going on than [in] facing the losses," he told the audience at ***Trading Risk***'s London ILS Conference on 4 April.

"In Switzerland, the main problem is not the relative or absolute attractiveness of the asset class," he added. "The mood is terrible from not really understanding the loss picture. It is more of an image problem than an attractiveness problem."

Similarly, Eveline Takken-Somers reported that there had been a wide variation in ILS manager performance with regard to assessing losses.

Takken-Sommers is senior investment manager at Dutch pension fund PGGM, which has $6bn invested in ILS and recorded a 0.6 percent loss last year from the segment.

"Negative loss development month after month is not a great thing," she said. "This is one of the main points that the industry could improve."

On the topic of inflows into the market Robert Howie, principal at Mercer Investments was more upbeat than Knecht.

He reported that Mercer had seen increased investments rather than redemptions, and currently has around $3bn of client assets allocated to the segment.

"We are having a number of conversations with clients looking to deploy capital into the ILS space," he explained.

However, he warned of deployment issues in the market.

"A lot of ILS managers are pretty capacity constrained," said Howie, recounting how one manager had told him it was not taking on any more capital because, while deals were available, the returns looked unattractive.

Kirsten van Exel, senior ILS underwriter at Aegon, said the business was still hoping to grow its ILS assets under management from $300mn to $1bn in five years, but that it was "not big in Florida".

She questioned the lack of alignment between Florida insurers and their reinsurers and claims inflation from litigation.

"You are playing in Florida for the "no-one knows" risk – that is why there is an uplift in the returns."

Takken-Somers noted that Florida rates had gone down by half since 2011, and that it was fair to question if it was well priced after the 2017 and 2018 losses.

"At the moment, you cross the point where from a standalone perspective it is not really attractive," she said.

Accepting there would always be volatility in the asset class, she added that ongoing loss creep meant everyone had "woken up" and, in her view, prices "should definitely go up".

Likewise, Howie said he had seen ILS managers move slightly back from Florida but had not seen anyone step away completely.

And Knecht pointed out that there was "no chance" of having a positive return in ILS without taking Floridian risk, given low absolute rates in other zones.

He said the problems around Florida's legal environment and alignment issues between managers, cedants and investors had always been known, but the need to address them was becoming more pressing.

Calling for structural improvements to help build trust he said: "Some of the true losses of 2017 have not been remunerated in the rate increases of last year."

The panel also addressed the use of side-pockets.

Howie defined them as a "good thing" with benefits for the market, but accepted investors had not anticipated the extent to which they could be used, with some finding half their portfolio was in side-pockets.

"Investors going into ILS need to understand that this is not just an asset class that pays claims but that sometimes you get your capital trapped for a period of time," he said.

Howie suggested structures that have worked well in ILS involve managers calling up fresh capital every six months or every year to invest.

Takken-Somers said part of the problem in monitoring side-pockets was that there were a lot of moving parts involved such as loss buffer tables, paid claims and reserves, leading to a number that evolved every day.

“People typically don’t report on the trapped capital,” she added.