Plenum
Insurance Linked Capital

Annual Review 2011

CAT Bond Market & Insurance Events

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CAT Bond Market

CAT Bonds losses due to earthquakes and tornados

The past year experienced an unusual amount of weather-related disasters and severe earthquakes. These events left their mark in financial terms on the CAT bond market. According to Munich Re, the insured losses amounted to around 105 billion USD trumping the previous highs set in 2005. Overall losses in the insurance industry in 2011 totaled around 380 billion USD. This is well above the 220 billion USD in 2005, also the previous record. The greatest contribution to overall economic losses came from the earthquakes in New Zealand and Japan in the first quarter of the year. The Tohoku earthquake in Japan alone caused economic losses of 210 billion USD, of which 40 billion was covered by the insurance industry. Although the damage reached new record levels, the sheer number of insurance-related events did not surpass the 10 year average. Munich Re estimated around 820 events, of which 90% were due to the weather. The one big exception for 2011 is that two thirds of the damage was caused by earthquakes. The regional distribution of the damage is also unusual: about 70% of economic losses originated in Asia.

The main events

Obviously the main event of the year for a CAT bond investor was the magnitude 9 Tohoku earthquake on 11th March, the strongest earthquake ever recorded in Japan. The quake triggered the CAT bond "Muteki" leading to a total loss of 300 million USD. This was the first time in the history of the CAT bond market that a parametric bond (i.e. a CAT bond in which the payment is defined on the basis of measurable physical parameters) was fully paid out. The earthquake that hit New Zealand in February 2011 and just before Christmas 2011 were not covered by any CAT bond. Never before have claims payments been made from three CAT bonds within the same year. The unusually violent tornado season led to massive insurance losses, surpassing the previous record by more than 100% . This led to the failure of two bonds, each with $100 million outstanding volume, which were issued by Mariah Re and protects American Family against losses from tornado events. On a more positive note although the hurricane season had an above average 18 storms no CAT bond was triggered as only three storms managed to reach the coast of the United States. Hurricane Irene, which effected the entire east coast of the United States, caused major damage, however it did not trigger any of the exposed CAT bonds.

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CAT Bond Market

Issuance Volume should recover in 2012

Although the ILS market started strong in the first quarter and ended with a healthy number of issuances in quarters 3 and 4, impacts from record levels of global catastrophic losses, as well as impacts from the release of the updated RMS U.S. hurricane model, caused the issuance levels for 2011 to be below initial expectations. In the first half of the year much less risk capital was transferred to the market than the year before dampening investor expectations for new issuances for the rest of 2011. But emission activity picked up in the third quarter, which is usually characterized by low emission volumes and the momentum continued into the fourth quarter. The high demand from investors was reflected in significant oversubscription of new issuances, which effectively increased the issuances volumes by the issuers. Fortunately, new sponsors came to the market, which underscores the increasing importance of capital market transfers as a strategic reinsurance option. Although the emission activity declined slightly to 4.6 billion USD and it did not reach the originally expected 5-6 billion it still resulted in a slight market growth in volume transferred to the capital market.

Outlook

The strong emission activity in the second half of 2011 has provided a good starting position for the coming year. For the first quarter of 2012, a well-filled pipeline is expected on new transactions. The reinsurance broker Aon Benfield expects primary and secondary trading volumes to be in line or above 2011. Because of the record losses incurred in 2011 the risk premium should increase in 2012. However this increase will be offset by a the sound supply of capacity from traditional and from the capital market sources. Nevertheless, CAT bonds continue to offer an attractive compensation for the risks assumed, especially in comparison with traditional capital market investments. The positive diversification properties due to the independence of risk factors that affect the traditional asset classes, will help to optimize the risk profile of investment portfolios and provide a partial protection against the currently prevailing risks and uncertainties to traditional investments.

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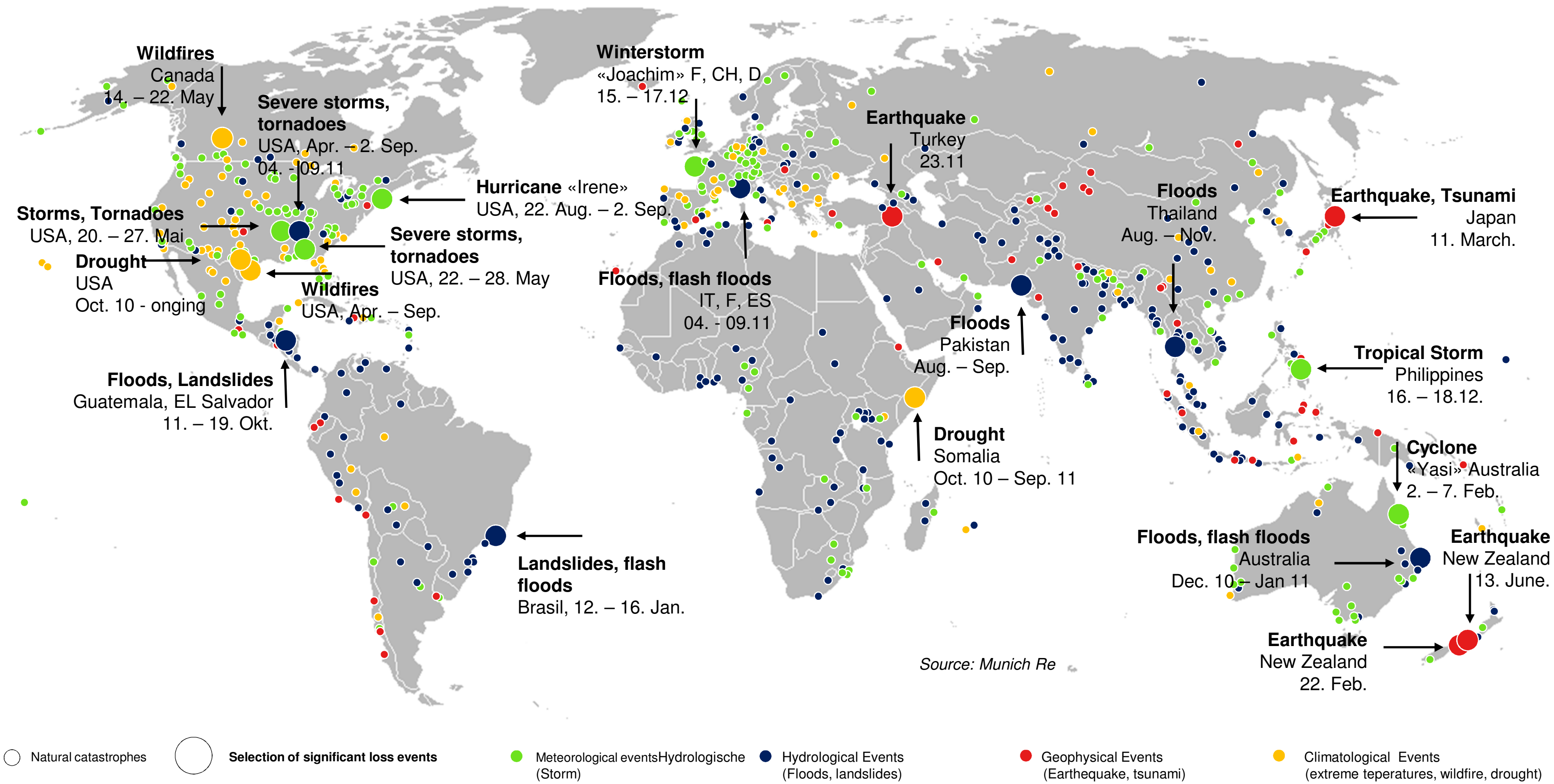
Natural Catastrophes 2011 (820 Events)



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CAT Bond Defaults (3)

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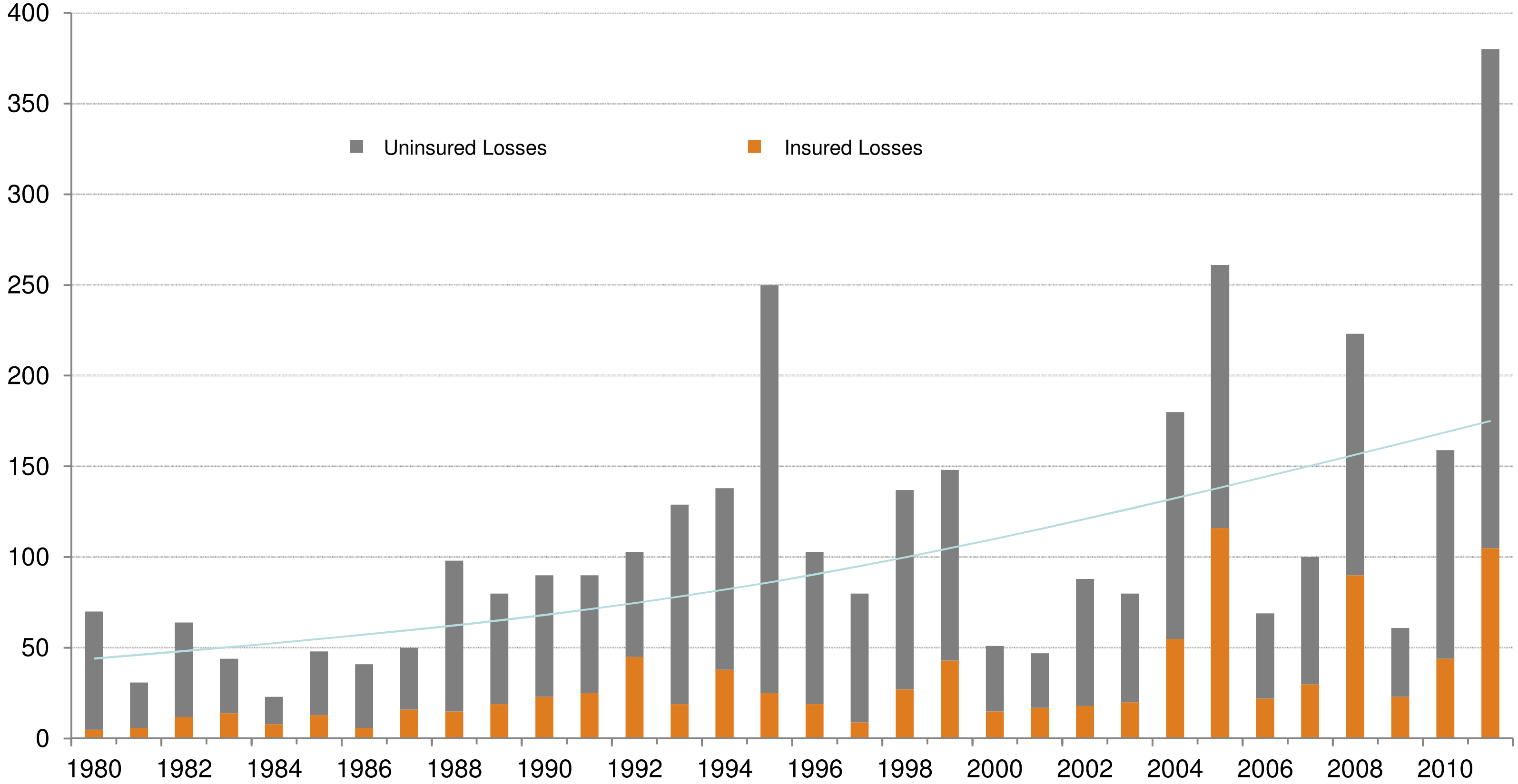
Total insured losses (inflation adjusted)



Source: Munich Re

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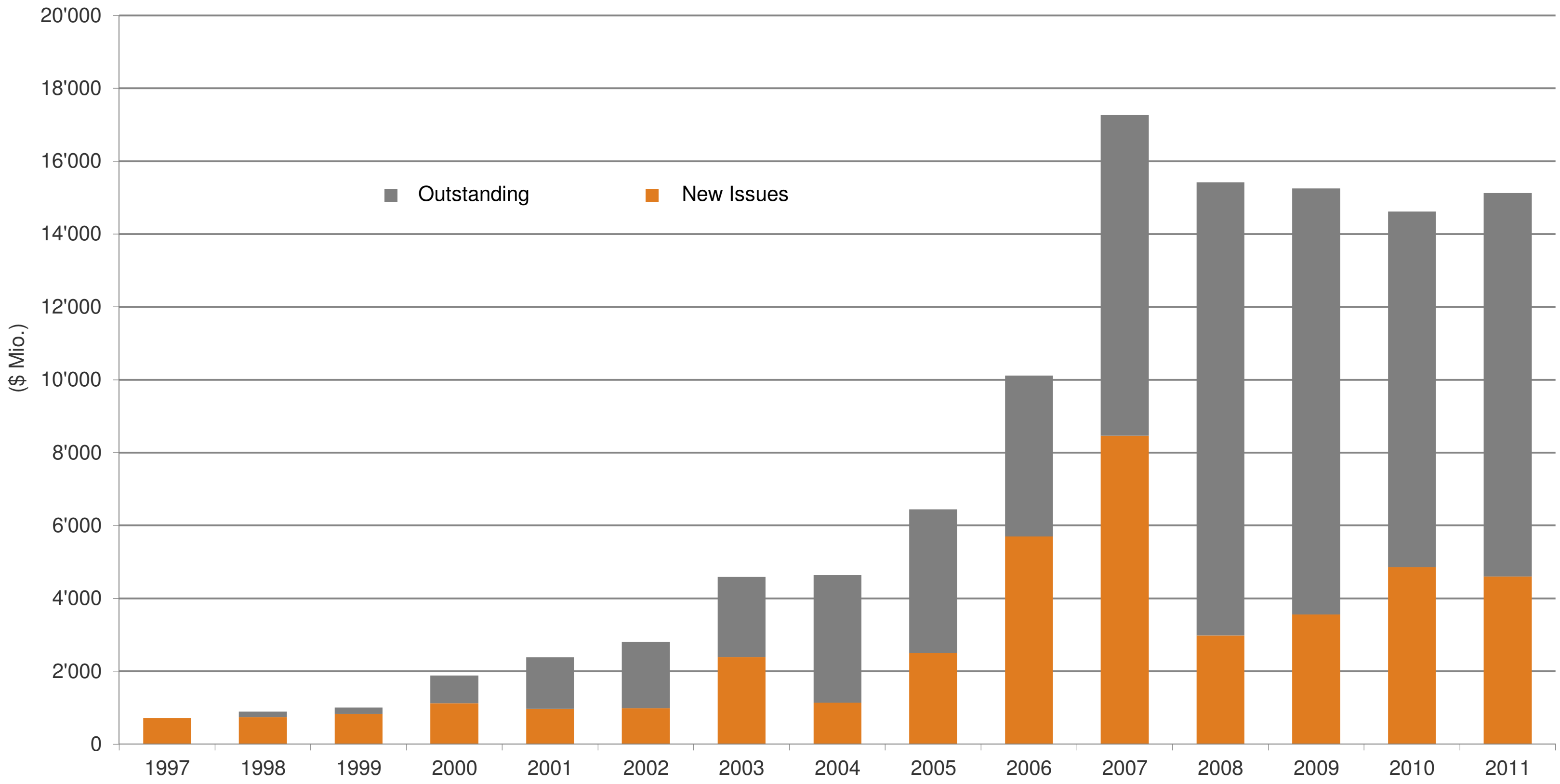
Development of the CAT bond market



Source: Swiss Re Capital Markets

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