Glacier Re: a wise start-up?

The reinsurance business is easy to get into, but notoriously difficult to exit. Andy Barile looks at what George Soros can expect from his recent $300m investment in Glacier Re

New capital coming into the reinsurance business, especially when attached to a successful hedge fund management manager like George Soros, always creates a good deal of excitement.

A financial investment in a reinsurance company without a track record of proven success is always considered a speculative investment. It receives further scrutiny when reinsurers have not traditionally been successful performers, especially compared to the investment returns that hedge fund operators are looking to achieve for their investors.

Why would hedge fund operators invest in a reinsurance company, when private equity firms in the insurance industry have not? What characteristics do they see that would make this an attractive investment? Let's look how we judge a reinsurance company by today's standards.

- Capitalisation – $300m.
- Management team/experienced reinsurance executives.
- Timing of the reinsurance underwriting cycle.
- Distribution – access to profitable business.
- Reinsurance produce focus.
- Modest growth plans.

Capitalisation: The initial capitalisation is modest by reinsurance standards, as many of the Bermuda reinsurance company start-ups were capitalised at $1bn, using private equity funds.

This is because "they will have to raise additional capital which could get the original investors to exit early having made their projected returns."

The $300m would make the reinsurer acceptable security for most ceding insurance companies, especially with no prior liabilities. In fact, a private letter ruling could be obtained from the rating organisations that are rating Glacier Re if they wanted to spend the money. Hedge fund managers will want to project the multiple they will get for their equity when they exit this investment.

Very few opportunities exist to invest in a start-up reinsurance company, especially one started in Switzerland (having worked for Swiss Re myself).

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Management team: Experienced and successful reinsurance executives are rare, which is why many of the Bermuda reinsurers brought reinsurance executives out of retirement. Hedge fund owners that invest in insurance firms need assistance in evaluating insurance and reinsurance executives.

Glacier Re is attracting reinsurance executives from other reinsurance companies. Nothing has changed. Thirty years ago, I was lured away from American Re to start a reinsurance company for a Lloyd's broker, which was ultimately sold at a substantial profit to a financial group in Florida. Glacier Re needs to put together a management team that can execute their business plan. That's the risk, can they do it?

Timing in the underwriting cycle: The hedge fund managers that have studied the insurance industry, or specifically the reinsurance industry, have recognised that pricing in reinsurance, and thus profitability, has run in cycles.

There will be times when a successful reinsurance company will walk from the business because their returns will not be made. Buyers of reinsurance have become more adept – and unwilling to let reinsurers earn substantial returns. If fact, reinsurance brokers will not let their insurance company clients overpay for reinsurance, especially after the revelations of New York Attorney General Eliot Spitzer's investigations.

Hedge fund owners, you make the call. Is it a good time in the cycle to invest in a new reinsurance company? Apparently, George Soros has thought so.

Access to profitable business: Hedge fund owners need to understand the reinsurance buying distribution system, and the uncertainty of its predictability. Reinsurance is a highly opinionated business. For instance, a London reinsurance broker was recently quoted in the insurance trade magazines saying: "The retrocessional market is still firm… but there is little need for additional capacity in most of the other lines that Glacier Re intends to write, so the reinsurer may have to offer lower rates in order to attract business."

New reinsurers need first to be approved by the security committees of the reinsurance intermediaries, then also by the ceding insurance company's (buyers of reinsurance) financial officers. All of this takes time, and may have precluded Glacier Re from obtaining much in the way of 1 January 2005 reinsurance business. Reinsurance intermediaries, especially the larger ones, have their own agenda in the marketplace.

Reinsurance product focus: The target focus for Glacier Re's reinsurance products are:

- Retrocessional business;
- Terrorism reinsurance;
- Aerospace reinsurance;
- Catastrophe reinsurance;
- European property and casualty reinsurance.

The hedge fund providing the investment in Glacier Re is backing the expertise of their underwriting management, and their assessment of the prices for these reinsurance products. On the other hand, some hedge funds are approached to write catastrophe reinsurance by investing directly in the catastrophe bond offerings.

These are two separately treated concepts that offer hedge funds different approaches to investing in the insurance industry.

Some hedge fund operators have already been successful in that they invested in the new Bermuda reinsurance companies, following the lead of the insurance private equity firms. Many of these investment successes have already been documented.

During this time of reinsurance price increases, the hedge fund manager may have been given a false sense of security, since reinsurance profits have been generated for new insurers operating after 11 September 2001.

The risk models may be skewed in the wrong direction, but do not take into consideration reinsurance price increases, a severe California earthquake, or unexpected Japanese typhoons, all of which could occur at the same time.

Modest growth plans: The hedge fund manager investing in Glacier Re needs to look at the size of the reinsurance marketplace and recognise that growth to $500m in reinsurance premiums is very modest and a conservative estimate.

The available worldwide reinsurance premium income in each of Glacier Re's reinsurance product lines runs into the billions of dollars, so market share is of very little consequence. Its reinsurance underwriting profitability is important and dependant upon the underwriting team making the correct risk selection. Reinsurance is a very easy business to enter, but a very difficult one to exit.

KEY POINTS

Few opportunities exist to invest in a start-up reinsurance company, especially in Switzerland.

Reinsurance talent is rare, hence many Bermuda reinsurers brought executives out of retirement.

Pricing and thus profitability of the reinsurance industry is cyclical.