# Insurance-Linked Securities

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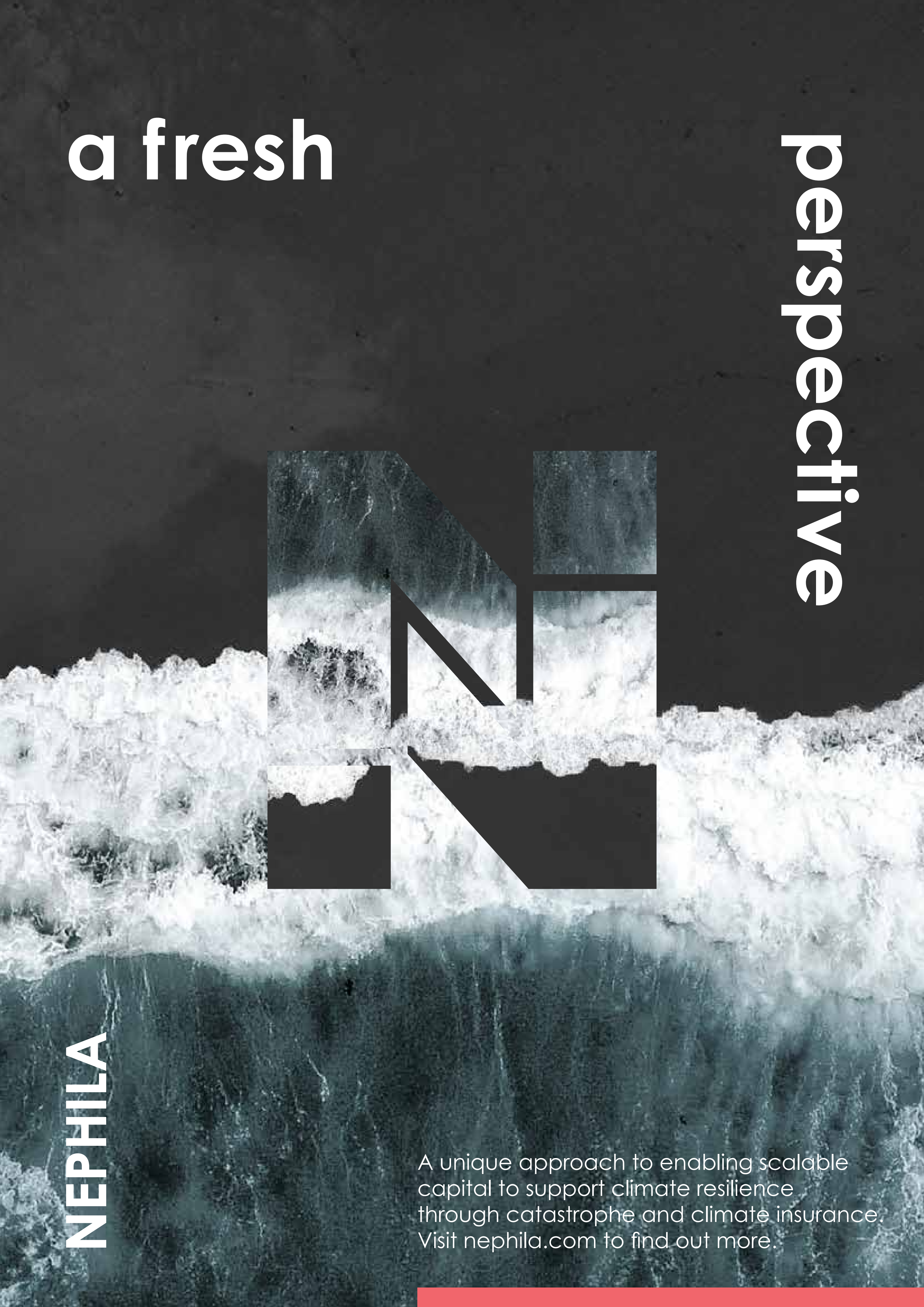
**A RISK-BASED APPROACH**
Successful ILS managers keep surprises to a minimum

**ACTIVE MANAGEMENT**
Balancing risk and return through proprietary analysis

**DIVERSIFIED PORTFOLIOS**
Growing appetite for ILS beyond cat instruments

**Featuring** Elementum Advisors | Hiscox | Nephila | Twelve Capital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# ILS to help satisfy investors' ESG appetite

By A. Paris

Large institutional investors are throwing their weight behind insurance-linked securities (ILS) with considerable allocations and mandates being handed down, despite the challenges experienced in the space since 2017. The asset class, particularly catastrophe (cat) bonds, proved resilient through the Covid-19 pandemic, living up to its diversification credentials. Further, with sustainability in investors' crosshairs, ILS which account for climate change risk are also growing in appeal.

"After big tests during the past three years, the ILS market remains resilient," details the Global Insurance-Linked Securities Market Survey Report from Willis Towers Watson. "Most end investors are satisfied with their ILS performance; 86 percent of ILS funds expect market growth of 5 percent or more cumulatively during the next five years; more than half of reinsurance and insurance companies surveyed world-wide now use ILS capacity."

The survey finds market disruptions from catastrophe losses in 2018/2019 and Covid-19 have not significantly dented enthusiasm for ILS investments. Over 80 percent of end investors either expect to increase their ILS allocation in the next 12 months or expect it to be unchanged.

"During Q1 2020, ILS demonstrated its diversifying benefits and low correlation characteristics with other asset classes, as the median fund posted slightly positive returns. It is worth noting that the catastrophe bond market did see some impact when, after positive returns in January and February, sales of cat bonds in March mainly by multi-strategy hedge funds led to a modest decline in the month. Many ILS managers saw this as a buying opportunity. Most ILS funds have significant exposure to private transactions, which did not experience the same mark-to-market losses as cat bonds over the quarter," Robert Howie, Asset Class Specialist, Diversifying Alternatives Boutique, Mercer, wrote in a recent article.

According to Don Steinbrugge, Founder and CEO of Agecroft Partners, current conditions are seeing a trend in pension funds and other large institutional investors seeking out less correlated alternatives, which is where ILS, cat bonds and other investments directly linked to reinsurance risks sit.

> *The most commonly used catastrophe models have not yet evolved to the point where they directly contemplate the effects of the global warming trend, leaving each manager to depend on their internal analytics capabilities to quantify the impact.*
>
> Jake Weber, Elementum Advisors

Some of the more notable rises in allocations within the past year came on behalf of the Coca Cola pension fund, the Healthcare of Ontario Pension Plan (HOOPP) and the Swedish national pension buffer fund AP3.

AP3, which has been investing in insurance-related securities since 2008 notes in its most recent annual report: "The strategy looked attractive when first designed 10 years ago. In hindsight, it has more than matched expectations. Returns have been favourable even in peak disaster years like 2011 and 2017.

"Holdings include catastrophe bonds, which are traded outside the traditional financial markets. Returns on these instruments have a low correlation with other investments, which means they help to diversify the portfolio.

Investments in insurance risk are strategic, long-term and help to make insurance markets more efficient. Pandemic insurance helps to channel capital quickly to relief efforts."

The Canadian HOOPP doubled its investments in the ILS space over the course of 2020, having hired Bernard Van der Stichele early last year as portfolio manager for its new ILS investment program. According to the plan's 2020 annual report, the total fair value of its ILS investments is USD549 million. This compares to the 2019 valuation of USD260 million.

### Climate concerns

Climate change is a critical dimension ILS need to take into account. AP3 outlines: "Analysing and tracking climate trends enables AP3 to make informed investment decisions. Climate change may be a rapid process geologically speaking, but from a financial perspective it is slow. AP3 invests in instruments with a maturity of three years, which means that their pricing adjusts much faster than climate risk."

"Generally, the asset class is considered to have good responsible investment (RI) credentials. This is because insurance has a positive societal benefit by providing a safety net to individuals, businesses and public entities (assuming premiums are reasonable) and supporting climate resilience," remarks Howie.

He goes on to outline how ILS can support climate resilience: "ILS contracts usually have a short term (mostly one to three years), whereas the impact of climate is likely to be a multi-decade phenomenon, creating a natural time-horizon disconnect.

"As the effects of climate change occur and the quality of climate data improves, we expect ILS pricing to adjust. Investors in an efficient market should therefore receive compensation through higher premiums for any increase in expected claims resulting from climate change."

Mercer believes natural-catastrophe-focused strategies for investing in ILS present a compelling opportunity in the current environment.

And managers are clearly aware of this. Jamie Rodney, Executive Director of ILS Analytics, Twelve Capital comments: "Climate change and ESG are prevalent topics in our dialogue with investors and discussed in almost every meeting."

In one example of the efforts to capture this opportunity, earlier in 2021, Nephila Capital launched an ESG impact fund. Greg Hagood, co-founder and co-CEO, Nephila outlines: "The past year has shaken awake many organisations that have neglected these mounting climate risks and has increased the appetite for Nephila's risk transfer solutions.

"Just as businesses with remote work strategies were better prepared for the pandemic, organisations with climate risk strategies will be better prepared for climate change. 'Theoretical' risks (e.g. a global pandemic or a warming planet) are becoming real, and organisations previously unprepared for global disruption do not want to be caught on the backfoot."

In the view of Jake Weber, Partner and Head of Analytics for Elementum Advisors: "Climate change is increasing the level of uncertainty in the ILS market, especially for investments covering the perils of hurricane and wildfire. The most commonly used catastrophe models have not yet evolved to the point where they directly contemplate the effects of the global warming trend, leaving each manager to depend on their internal analytics capabilities to quantify the impact."

According to Richard Lowther, managing partner at Integral ILS, the connection between ILS and sustainability needs to be further quantified. In an interview with The Insurer TV, he spoke of the need for a framework to measure progress against ESG objectives: "An independent framework to score ESG would be extremely helpful, as right now it is largely a self-certification process." Lowther believes a structure which enables that would "be a win for investors and the ILS asset class as a whole." ■

# Diversified ILS portfolios are the future

Interview with Greg Hagood

Interest in insurance-linked securities (ILS) is moving beyond catastrophe instruments, although this is the most mature sector. There is growing appetite for climate related impact products and specialty insurance lines focused on issues like aviation, terror and cyber.

"We expect increasing demand for ESG ILS strategies and for other lines of insurance that complement core catastrophe holdings," observes Greg Hagood, co-founder and co-CEO, Nephila. "Interestingly, while each of the catastrophe, ESG and specialty ILS strategies have a low correlation to financial markets, the individual strategies also have a low correlation with one another, thereby making a multi-strategy ILS approach of growing interest to some investors."

Nephila currently manages two strategies outside of the cat (re)insurance space; one is tied to ESG/Impact and essentially provides risk transfer products to sectors such as renewables and agriculture. For example, the renewables contracts are tied to lack of wind, rain or sun for the underlying project and the strategy thus has low correlation to financial markets. The second strategy is centred on specialty insurance lines such as aviation, terror, and cyber.

"In a world where correlations across assets continue to increase, we expect growing demand for truly non-correlated strategies; ILS offers that. We expect more focus on climate change and how that changes the risk assessment and pricing for catastrophe ILS exposures," Hagood explains.

Discussing the opportunities in the climate space, he notes: "Global trends from this past year toward increasing sustainability and decreasing uncertainty serve as tailwinds to our business. Our core strength is analysing climate risk and offering solutions to limit organisations' exposures.

"There is unprecedented momentum to decarbonise society and to recognise climate risks. Renewable energy projects are proliferating, electric vehicle adoptions are accelerating, and sustainable agriculture practices are sprouting. Coupled with these climate-forward projects are efforts to quantify climate risks. Governments, shareholders, and consumers are demanding that organisations disclose how climate change will impact revenue on income statements and assets on balance sheets. After publishing this information, groups want organisations to limit their exposure to climate-related risks by selling or insuring their assets."

With increasing focus on climate change and quantifying corporate disclosures around it, Hagood expects a growing need for risk transfer products in the ESG sector as well as increasing investor interest to support these initiatives.

He says: "The past year has shaken awake many organisations which have neglected these mounting climate risks. This has increased the appetite for Nephila's risk transfer solutions. Just as businesses with remote work strategies were better prepared for the pandemic, organisations with climate risk strategies will be better placed for climate change. "Theoretical" risks (e.g., a global pandemic or a warming planet) are becoming real, and organisations previously unprepared for global disruption do not want to be caught on the backfoot. As a result, they are reaching out to Nephila to limit their climate exposure."

### Specialty insurance risk products

On the non-cat side, Nephila is preparing to launch a specialty insurance risk strategy next year. "There is demand to broaden ILS exposure into other types of risk. We have built a diversified portfolio of specialty risks including classes like cyber risk, terrorism, aviation and energy, which will complement our existing catastrophe and climate strategies," outlines Hagood.

The main challenges with this type of strategies are access to risk and creating the right structure to allow investors to enter and exit the exposures with reasonable liquidity. Hagood elaborates on how Nephila has tackled this: "We have been investing in a platform at Lloyd's of London since 2013 for our catastrophe risk products. This investment in Lloyd's provided an ideal home for a new specialty risk product. Much of the target risk trades in the London market and Lloyd's provides a structural solution that can work for our investors. Nephila's team in London will underwrite this portfolio and manage the product."

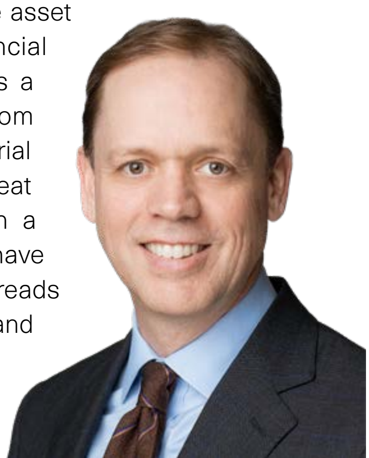
By and large, the specialty market has benefited from a broad upturn in the pricing cycle and many target lines of business are seeing stronger pricing and attractive underwriting opportunities.

Different sources of return within the ILS market allow investors to spread risk within their portfolios. The catastrophe ILS arena is by far the most mature sector with investors globally allocating to it, typically on a standalone basis. However, given these growing areas are also uncorrelated to one another, they enable investors to build a diversified portfolio with low correlation to financial markets which can earn them a positive return over time.

Looking ahead, Hagood comments: "There will likely be more competitors in ILS to service this increasing demand, but the winners will likely be those who have experience in origination, risk assessment and pricing, plus a platform that can stay on top of a rapidly changing landscape."

Nephila Capital started in 1997 and the current bulk of its USD9.5 billion in assets under management focuses on building portfolios of catastrophe risk.

Hagood details the growth of the ILS asset class: "From 1997-2005, investors were generally unfamiliar with the sector and most of our time was spent educating them on what it was and why it would benefit their portfolios. In 2005, post Hurricane Katrina, the market grew materially because very wide spreads attracted new capital. In 2009, the market took another big step forward as investment consultants saw the non-correlation of the asset class hold during the Global Financial Crisis and began advocating for it as a strategic allocation for investors. From 2006-2016, there were very few material catastrophes and investors had a great run. More recently, there have been a number of catastrophe events that have caused losses in the market, but spreads have widened for four straight years and pricing is back to levels not seen since 2013." ■



**Greg Hagood**
Co-Founder and Co-CEO, Nephila Advisors

Greg co-founded Nephila Capital. Today, he is co-CEO of Nephila Holdings and a Director of Nephila Capital. Greg focuses on investor relations, risk management and the firm's strategy. He started at Bear Stearns in New York, where he managed the mortgage servicing desk. In 1997 he joined Willis Group in London to help start up what is now Nephila Capital. He has been a licensed broker at Lloyd's of London and has a BSc in Finance from the University of Tennessee.


Meaning element or first principle, Elementum is an alternative investment advisor specializing in natural-event exposed risk-linked investments.
With broad experience managing a range mandates – from liquid catastrophe bonds to high-alpha collateralized reinsurance investments – our team provides best in class service to a wide spectrum of investors worldwide.
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# Proprietary analysis key to active ILS management

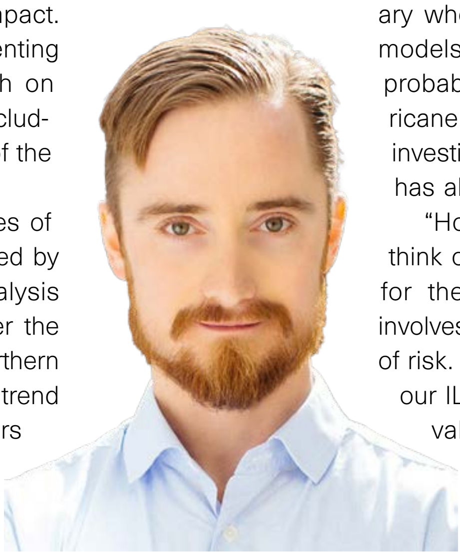
## Interview with Jake Weber

The peak perils of hurricane and earthquake receive the most attention when catastrophe risk gets transferred in the insurance-linked securities (ILS) market. However, non-peak perils can contribute risk to ILS investments that may be difficult to quantify and easy to overlook. This is one reason why proprietary analysis is critical in this space.

"The recent wildfires in California and winter storms in Texas prove the exposure is real," highlights Jake Weber, Partner and Head of Analytics at Elementum Advisors, LLC. Noting the comprehensive nature of the firm's view of risk, "we consider each investment's exposure to any covered perils of consequence. When risk metrics for a transaction are presented to us that exclude the impact of non-peak perils, we perform due diligence to recalculate the metrics using our own assumptions, under which no catastrophe should show up by surprise."

He explains that the most commonly used catastrophe models have not yet evolved to the point where they directly contemplate the effects of the global warming trend, leaving each manager to depend on their internal analytics capabilities to quantify the impact. "Elementum has been actively implementing ways to incorporate the latest research on climate change into our view of risk, including carrying out our own investigations of the source data.

"We performed an analysis of decades of wildfire activity using information compiled by various government agencies. Our analysis showed a meaningful upward trend over the period analysed in the area burned in Northern California and the Pacific Northwest – a trend that was not contemplated by the builders of the market's most widely used wildfire model. Our firm's comprehensive view of risk for US wildfire is now based on a stochastic event catalogue, which we have augmented with additional simulated fires in order to reflect the heightened risk."



### Proprietary views on risk

So, although all ILS market participants have access to risk metrics generated by the same catastrophe models, it is the responsibility of each investment manager to understand a model's underlying assumptions and to know how to interpret its results. Weber describes how Elementum performs work to validate how a model was built: "We make adjustments to a model's output when we can confidently quantify something that the model builders have not incorporated. In cases where the available catastrophe models leave a peril unmodelled, we develop our own method for probabilistically simulating losses that the peril could cause to ILS investments."

Weber goes on to acknowledge that the ILS market is opaque. Therefore, he believes in-house analytics capabilities are essential for an investment manager to be able to confidently quantify catastrophe risk. He elaborates: "A typical investment opportunity will be brought to the ILS market by an intermediary who has used sophisticated catastrophe models to estimate certain metrics, like the probability of default due to a covered hurricane. To the uninitiated, this might feel like investing in a world where the analytics work has already been carried out by an expert.

"However, dedicated ILS managers will think of those estimates as the starting point for their own quantitative analysis, which involves the development of a proprietary view of risk. Because Elementum actively manages our ILS portfolios in our drive to find relative value, the investment opportunities we consider must be analysed within a consistent framework. Harmonising a transaction's risk metrics to

Elementum's view is an important part of the investment process, providing a coherent foundation that can help us find profitable trades–and avoid losses."

### Importance of active management

The perennial challenge for all investment managers is to find investments that generate the best risk-adjusted returns without simply buying-and-holding the market's flow of investment opportunities at the market's terms. This is also the case in the ILS market.

In Weber's view: "A new ILS manager would not need much expertise or discipline to put capital to work by passively holding any investment with the potential to generate a positive return during a catastrophe-free year. However, to truly know the relative value of each ILS transaction, a breadth of experience is needed to carry out the due diligence of independently analysing catastrophe risk. In addition, a sustained mindset of active yet disciplined management must be in place for managers to construct a balanced portfolio."

In view of this, Elementum aims to help solve challenges for both capital providers and transaction counterparties. Discussing the way the firm creates investment opportunities toward the goal of generating desirable expected returns, Weber focuses on Elementum's privately negotiated transactions: "We believe that our long-term relationships with certain counterparties have enabled us to source investments with more favourable terms and conditions than those generally presented to the broader ILS market."

In addition, the firm's use of relative-value investing enables the manager to adapt to changing circumstances. Weber comments: "Looking at the market dynamics that emerged as the 2021 Atlantic hurricane season was about to get underway, relative to other ILS investments, we saw a significant re-pricing of ILWs, which are investments whose payout would be triggered by industry-wide insurance claims. In our experience, a manager who assumed risk via ILWs would be agreeing to a less attractive risk/return trade-off than before. We reacted by dynamically tilting the construction of certain portfolios, using ILWs as relatively inexpensive hedges in order to cede a portion of the catastrophe risk and avoid potential losses."

Considering the role ILS plays in portfolios, Weber underscores the enduring value of ILS continues to be its ability to generate return streams which are largely independent of those generated by traditional asset classes: "As the global economy emerges from the effects of the pandemic, capital allocators are focused on the unprecedented challenge of identifying the sectors with the most pent-up demand but the fewest supply-chain headaches, all while forecasting the response of central bankers to unknown inflationary pressures.

"In our view, having an actively-managed ILS investment that seeks to generate attractive, risk-adjusted returns continues to be an important counterbalance to the other types of risk that can stress an investment portfolio, whether from old sources or new." ■

**Jake Weber**
Partner and Head of Analytics, Elementum Advisors

Jake Weber is Partner and Head of Analytics at Elementum Advisors, LLC. Jake is responsible for Elementum's view of risk, leading the firm's research on how to best quantify the impact of hurricanes, earthquakes, and other perils on catastrophe bonds and collateralised reinsurance investments. He also leads Elementum's work on how climate change affects the way catastrophe risk is modelled. Prior to the founding of Elementum, Jake was a member of the reinsurance and risk-linked investments team at Stark Investments. He started his career at Aon in 1999, working in catastrophe modelling, catastrophe bond securitisation, and catastrophe bond trading. Jake holds an MBA in Finance and Econometrics from the University of Chicago, a Diploma in Economics from the London School of Economics, and a BA in Economics from the University of Illinois.

# Understanding risk when building ILS portfolios

## Interview with Dr Jamie Rodney

After suffering considerable losses in 2017, investor faith in insurance-linked securities (ILS) might have been dented. However, investor appetite and demand for the asset class persisted as trustworthy managers with robust investment processes have shown clients they understand the risks within the portfolios they construct.

"Successful managers tend to be those who don't chase return but have a focused risk-based approach to investing in ILS," explains Dr Jamie Rodney, Executive Director, Twelve Capital. "The main factor ILS managers need to keep in mind is to ensure there are no surprises. If investors see a headline loss in the papers, then they are more likely to understand a hit on performance.

"However, losses which are not expected are harder to accept, especially if they are due to the way contracts are underwritten and therefore don't cover risks appropriately. With losses like these, it can be easy for investors to lose faith in the manager and potentially in the asset class."

The ILS market has seen significant dispersion in terms of performance and Dr Rodney stresses the importance for investors to understand the product: "Investors need to acknowledge that because one manager or product has negative performance, it doesn't necessarily mean that the whole segment will perform poorly.

"Investors have been spurred to assess the type of ILS allocation they are making. After 2017, everyone put ILS in the same bucket when actually they present a diverse set of risks and opportunities. However, the performance differentiation has made investors question what kinds of losses they are taking and how their portfolio is constructed. Managers who delivered strong performance over the last two or three years would have built their portfolios in ways to mitigate the underlying risks. Spread levels reached multi-year highs in 2020 and well-constructed portfolios are well positioned to deliver improved risk-adjusted returns when compared to previous years."

## Diversification benefits

Risk is a critical element ILS managers need to consider. "We invest a lot of time trying to understand risk. Our part of the industry, at its core, is extremely risk aware," states Rodney.

He also highlights that the last two years have seen new risks coming to the market – risks like wildfires, floods and terror. This year has also seen the launch of the first catastrophe (cat) bond for volcano eruptions, which shows the potential for growth in new areas.

These new risks being identified also improve ILS's potential for diversification, which is the asset class's primary role within investor portfolios. This is particularly relevant for cat bonds.

"In 2020 cat bonds showed their diversification benefit, which is driving some of the current demand from investors. They have been relatively insulated from the worst of the losses and performance has been attractive. Also, the pandemic has had very little impact on cat bonds which breeds confidence among investors," Dr Rodney outlines.

"The primary selling point of ILS has always been the diversification benefits they offer within wider investment portfolios and this is not due to change. It's easy for people to comprehend that financial market distress does not cause a natural disaster. Therefore, they understand that an ILS allocation can provide diversification and enhance the risk adjusted return of their entire portfolio."

However, although the role of ILS within portfolios is well established, investors need to be aware of the way they manage the ILS risk within their wider asset allocation. "Unless you have a highly diversified ILS portfolio, it can be very tail heavy. So investors need to make sure their allocation is managed well from a risk perspective."

## Ahead on climate risk

As sustainability and environmental concerns continue to rise on investors' agenda, Rodney draws attention to the fact that ILS managers are ahead of the game in some respects: "ILS might be one of the most risk aware industries especially with regards to climate change and its impact on financial instruments.

"Climate change has always been the hot topic in the ILS space. It's very easy to associate the risks we invest in with climate change; a risk which is very simple for investors to label. Further, regulatory and administrative pressures around ESG have been rising in the last year or two, which have led to additional considerations.

"It's increasingly challenging to communicate complex ideas in a simple way, especially with regards to climate change. An important part of our job is to give investors comfort to understand concepts which appear to be very complex. As managers, it's our role to educate our clients and build processes and transparent procedures to help people get a grip on this complexity in a straightforward manner."

In evidence of its commitment to assessing climate change risk, Twelve Capital has partnered with reask, a catastrophe analytics specialist providing global solutions for tropical cyclone risk management and forecasting. The firm's climate-aware Tropical Cyclone risk framework provided Twelve Capital with a view of what to expect for hurricane risk under a warming climate.

Rodney comments: "Technology like this can help us understand what happened in the last 20 years and what could have happened within different scenarios. Once we have the understanding of the pure risk these factors pose, we can build processes to incorporate those measures into what we communicate to our portfolio managers and turn them into useful metrics.

"We need to make sure this process is clear and transparent. It must enable the portfolio manager or the investment decision maker to interpret those results and make an investment decision by incorporating the latest science into those choices." ■

**Dr Jamie Rodney**
Executive Director, ILS Analytics, Twelve Capital

Dr Jamie Rodney joined Twelve Capital in February 2018. Prior to joining the firm, Jamie worked at Willis Re where he was a team leader responsible for developing analytical solutions to model natural perils and reinsurance programs in Africa, the Middle East and Turkey. Before joining Willis Re Jamie was a pricing analyst at Tokio Millennium Re specialising in pricing property treaties across multiple territories. Jamie started his professional career as a model developer at Risk Management Solutions (RMS), in 2012, where he developed state-of-the-art catastrophe modelling tools for assessing the financial cost of natural disasters. Jamie holds a First Class BSc degree in Mathematics and a PhD in Applied Mathematics both from University College London.

# Performance dispersion prompts flight to quality

Interview with Dr Benjamin Fox & Aaron García Ehrhardt

After a benign catastrophe environment lasting several years, the insurance-linked securities market was tested by considerable losses following a number of natural disasters. While some investors may have been hit hard by these events, it gave others the opportunity to differentiate between ILS managers and their approaches.

There is a recognition that the current hard market represents the best risk-adjusted pricing environment since 2012. This has led to increased interest and a deeper appreciation of the way the asset class works.

"In recent years, the industry experienced heightened levels of natural catastrophes whereby average performance may have underwhelmed investors, compared to what they experienced four or five years ago. The recent experience has allowed investors to understand more about an asset class in which, most of the time, nothing significant happens," comments Dr Benjamin Fox, Principal, Portfolio Manager at Hiscox ILS.

This period of greater dispersion of returns has also given investors an opportunity to gain more insight into what really drives performance. Fox notes: "It allows investors to make an informed decision about which ILS managers to select as there is more to differentiate them now. In fact, we have seen a flight to quality in capital inflows. In the case of Hiscox ILS, we are pleased to see our active assets under management grow by 25 percent in Q2 this year."

Fox details the characteristics of ILS investment more broadly: "Our investors' capital is typically used to support the transfer of tail natural catastrophe risk from the traditional reinsurance sector to the wider capital markets. For those unfamiliar with ILS, I often describe our strategies as like 'selling call options on Mother Nature'."

## Understanding performance

It is worth highlighting that by the nature of the risk, the ILS asset class does not provide many data points for investors to critique performance. "In recent years, there has been a growing awareness that partnering with organisations like Hiscox ILS – which are able to leverage the expertise and experience of a century-plus old (re)insurance group – leads to stronger performance," Fox adds.

For instance, following a significant catastrophe event, claims are often complex and can take time to develop. While these factors can be extremely challenging for managers with limited resources and practice, Hiscox has a successful track record of delivering reliable and robust valuations for its funds.

With asset prices high across many sectors of the investment landscape an investment in ILS continues to look appealing. "The current environment represents an opportunity to grow the ILS market and also develop innovative solutions for those seeking financial protection, in both cases we see a range of attractive investment opportunities for our investors," Fox outlines.

For long-term investors who see ILS as a strategic position in their portfolios, their commitment has remained strong and, in many cases, their tactical allocation to the class was overweight versus their strategic targets.

In addition, ESG factors are increasingly a big focus for investors. Aaron García Ehrhardt Principal, Portfolio Manager at Hiscox ILS, notes: "At Hiscox ILS we are a big supporter of many of the World Bank and other similar development agencies' initiatives to transfer risk to the capital markets and are happy to put our investor capital to work assuming transactions are well-structured, well-understood, and well-priced."

More broadly, Fox discusses: "The nature of the risk is constantly changing, climate change, increase in coastal population and wildfire-urban interaction (WUI) changes are examples of this. At Hiscox, we devote resources to research the impact of these changes, and develop tools that help us quantify, monitor and manage their impacts."

## Improving models

Outlining the way technology has supported expansion in the ILS sector, Fox remarks: "Natural catastrophe models are used as the currency of risk in our asset class. Like all models, they have utility, but require careful augmentation and implementation to be most effective."

Hiscox ILS investors benefit from the manager's relationship with the wider Hiscox Group which licenses all of the major catastrophe models and calibrates them based on their own research.

Fox highlights: "While we regularly update our views on the models' strengths and weaknesses and supplement as we see fit, we have long been lobbying the providers of these models to better capture the additional uncertainty that comes with climate change.

"Although the response has been slower than anticipated, we are pleased to see positive developments which should give investors the confidence that, as an industry, we are using the most appropriate views of risk available."

## Cyber ILS offers an attractive investment opportunity

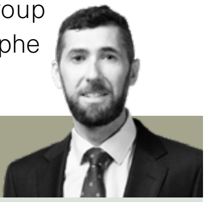
The Hiscox team also identifies the growth outlook for cyber ILS should be considered within the broader industry context where participation and experience in the asset class has helped investors become more sophisticated in their approach to ILS.

Global cyber insurance premiums tripled over the last seven years and reinsurers are facing accumulation issues, similar to those existing in natural catastrophes. Given this, cyber is tipped to be the most prominent growth opportunity within the ILS universe.

"The number of cyber insurance claims is increasing exponentially every year, with insurance premiums having grown three-fold over the last seven years" explains García Ehrhardt. "Cyber risk has commonalities with catastrophe risk. Although attractively priced, too much of it is problematic for insurance and reinsurance companies, who face accumulation issues and look for solutions to transfer part of the risk off their books."

Investor appetite for these instruments has been positive. García Ehrhardt remarks: "We are seeing a high level of interest in cyber ILS on behalf of all our investors. We are currently working on investable structures, but there are a few challenges that still need to be overcome."

The notion of insurance and reinsurance companies using securitisation to transfer risk off their balance sheets was what led to the inception of the ILS market in the first place. So the move to doing the same with cyber risk is the next evolution in the market. ■



**Ben Fox**
Principal, Portfolio Manager, Hiscox ILS

Dr Ben Fox joined the Hiscox ILS team as a Portfolio Manager in April 2018. Based in Bermuda, Ben is jointly responsible for portfolio management across Hiscox ILS strategies. Prior to joining Hiscox, Ben worked at the Ontario Teachers' Pension Plan (OTPP) as Principal of Insurance-Linked Securities. Ben has also worked at the World Bank, Aon Benfield and RMS. Ben graduated from the University of Oxford, UK in 2002 with a Master's Degree in Earth Sciences followed by a DPhil Seismology in 2007.

**Aaron García Ehrhardt**
Principal, Portfolio Manager, Hiscox ILS

Aaron García Ehrhardt joined the Hiscox ILS team as a Portfolio Manager in September 2017. Based in Bermuda, Aaron is jointly responsible for portfolio management across Hiscox ILS strategies. Prior to joining Hiscox, Aaron worked at Lloyds Syndicate Novae in both Zurich and Bermuda as an international property catastrophe underwriter and as a broker at JLT in London. Aaron graduated with honours from a double degree BA programme in Business Administration at the University of Cardiff, UK and IESIDE Business School, Spain in 2010. Aaron holds a US Chartered Property Casualty Underwriter designation (2016) and is a Chartered Financial Analyst (2019).

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### ELEMENTUM ADVISORS

Elementum Advisors, LLC is an independently-operated alternative investment advisor specialising in collateralised natural event (re)insurance investments. Working from offices in Chicago and Bermuda, Elementum's team possesses a lengthy track record of portfolio management experience across a wide spectrum of (re)insurance and risk-linked investment mandates – from more liquid catastrophe bond to higher risk collateralised reinsurance investment strategies. Since its launch in 2009, Elementum has strived to be the global ILS partner of choice, providing best in class service managing portfolios across a breadth of risk-linked investments.

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### HISCOX ILS

Hiscox ILS is an established investment manager providing insurance-linked investment strategies for sophisticated investors. Operating as an independent ILS management team since 2013 within Hiscox, our business structure enables us to offer a broad range of ILS strategies to meet investors' needs. A long-term investment partnership with us connects you with an institution with more than 100 years' experience within the global (re)insurance industry.

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### NEPHILA

Nephila is a leading investment manager specialising in catastrophe and non- catastrophe specialty (re)insurance, climate and weather risk and was the first to focus on the convergence of these risk transfer markets with capital markets since launching its first ILS fund in 1998. Nephila offers a broad range of investment products across its robust platform. The platform includes Nephila Climate, a dedicated weather and climate risk transfer and ESG-driven business and Nephila Syndicate which offers non-cat specialty lines of business. Nephila has approximately USD9.5 billion in assets under management as of May 1, 2021 and is headquartered in Bermuda, with offices in San Francisco, CA, Nashville, TN and London. There are currently over 140 employees with expertise in finance, seismic engineering, catastrophe modelling, risk management and traditional underwriting.

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### TWELVE CAPITAL

Twelve Capital is an independent investment manager specialising in insurance investments for institutional clients. The company is also a leading provider of capital to the insurance and reinsurance industry.

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