

reinsurance

MORE THAN JUST A LEADING MEDIA BRAND |||||



CASHING IN

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Still a good investment

With talk of further consolidation and M&A activity in the sector, Reinsurance asked **William Spiegel** of Pine Brook a leading US Private Equity company for his views on the industry and whether the private equity approach to the reinsurance and risk market needs to differ from its approach to other sectors

WORDS:
Jon Guy

How does PE investment strategy differ in the reinsurance market to that in other sectors? Given the perceived lack of exits over recent years which goes against the layman's understanding of a PE business.

While I can't answer for other PE firms, at Pine Brook, we have a very simple economic framework we use to determine if a particular financial services sector merits our investment attention. Pine Brook looks to invest in sectors where there is a need for capital, which will allow us to earn a good return on equity. This creates a compelling opportunity for Pine Brook to either start a new company or recapitalize an existing company. We prefer that the need for capital be large and long lasting, so that we can earn good returns on our equity investment for a long period of time.

Furthermore, we like the sectors we invest in to have significant barriers to entry. These can be created by distribution, technology, licensing, investment strategy, etc. Investing in the P&C reinsurance sector is difficult because, while the sector often has significant capital needs, there are very few barriers to entry. Consequently, positive returns can be arbitrated away very quickly.

Given the demand for ROI do you believe PE firms are exerting downward pressure on the actual business of reinsurance?



I don't believe that PE firms are exerting downward pressure on the reinsurance business.

PE investors generate returns in the financial services sector by investing in companies that can generate a solid and sustainable Return On Equity (ROE). These companies trade at premiums to book value because the operating ROE is generally higher than a public market investor's cost of capital. PE firms understand that if they invest in companies that earn 15% ROE, they can sell for twice the book value in five years.

Several commentators suggest not but do you believe conditions are right for IPOs? Can we expect an increase in deals between those PE firms

who have reinsurer interest while the IPO market remains slow?

Due to stock market volatility and the uncertain economic conditions, IPOs face strong headwinds. The volatility of the P&C reinsurance market and the lack of significant barriers to entry, generally make these companies difficult public stocks because they are inherently indistinguishable from one another. What sets some reinsurers apart, allowing them to trade at premiums, is the sustainability of their ROE, which reflects the quality of their management.

Do you expect to see further PE funds turning towards the Lloyd's markets and away from the Bermuda and the US markets?

The P&C reinsurance markets are global, each piece of the business is up for renewal nearly every year, and they are controlled by a very small number of brokers. Therefore, a reinsurance company must be located where there is a critical mass of insurance talent and in a jurisdiction that the brokers visit. The U.S., London and Bermuda are all viable jurisdictions. Lloyd's represents a special market because of its global licenses, ratings and capital requirements, and new entrants have been severely restricted. Presently, the only way into Lloyd's is to buy someone, so we don't see investors abandoning the US and Bermuda. □