


# Bermuda:Re+ILS

GLOBAL RE/INSURANCE AND ILS FROM A BERMUDA PERSPECTIVE



## Adversity and opportunity: Jamie Veghte on XL's continued commitment to success

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An interview with RenaissanceRe's new CEO, Kevin O'Donnell

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## Leadership in adversity and opportunity

*Bermuda Re/insurance*

*Reinsurers face an increasingly dynamic and challenging marketplace. Bermuda:Re spoke with Jamie Veghte, who leads XL Group's Reinsurance Operations, about how the reinsurer is positioning itself to leverage the potential of convergence capital, while pursuing opportunities in both mature and emerging markets.*

**T**he reinsurance sector is facing a period of unprecedented change and adversity, with rising levels of convergence capital and increasing insurer retentions in more mature markets, creating something of a perfect storm for the industry. Talking with Jamie Veghte, chief executive of XL Group's Reinsurance Operations (XL Re), however, it is clear that he is circumspect about the continuing role and value of reinsurance in the face of such adversity.

Addressing rising levels of convergence capital, Veghte was clear that he regards this additional capacity as an opportunity for the reinsurer to complement its existing portfolio with additional third party capital, rather than as a challenge to XL Re. Veghte said that in spite of the headwinds experienced by some in the sector, he was confident that XL Re's "ability to draw on a 20-plus year track record of successful



underwriting and a 20-year loss ratio on property catastrophe business that has cumulatively been in the mid-40s” will set it apart from the competition—enabling it to attract and retain third party capital in the long term.

Veghte’s confidence is not without substance. XL Re has considerable experience in the third party space, having established its sidecar Cyrus Re almost a decade ago, following Katrina, Rita, Wilma in 2005. Veghte said that he was in no doubt that XL Re’s underwriting strength and experience in the third party space would place it in good stead as the industry adapts to the new norm created by rising levels of convergence capital.

XL Re’s announcement that it would be partnering with private equity firm, Stone Point Capital, to create a new company that will manage third party capital in the convergence space and provide companion capacity to XL Re’s traditional reinsurance operations, reflects the reinsurer’s continuing commitment to the convergence space. As Veghte explained, “our participation in the third party space is not new, but our venture with Stone Point demonstrates our continued commitment”.

Veghte said that the initiative with Stone Point “fits our strategic objective of providing further product innovation to our clients and delivering long-term value”. The new Bermuda-based entity will benefit from “XL’s underwriting capabilities and Stone Point’s proven track record of investment success”. The two companies will be investing \$135 million into the new company initially, with the expectation being that the venture will attract strong levels of third party capital, drawn by the expertise both parties bring to the table. Veghte said the new entity will offer investors “unique access to both reinsurance capital products and traditional XL Re opportunities”.

These opportunities in the third party space are likely to be sustained, according to Veghte. “In the near term it is quite naive to expect these sources of capital to run for the hills in the event of a major loss or rising interest rates. We expect that alternative sources of capital will expand and contract based on a number of factors—the interest rate environment, the performance of other investment markets, catastrophe activity and capital conditions in the P&C market—but we expect it to be a permanent feature of the market; one that will ebb and flow. We therefore view our own participation in this space as essential,” enabling XL Re to offer greater product innovation to its clients.

Product innovation will form a key aspect of XL Re’s efforts to continue to deliver lasting value to its clients, said Veghte, some of whom have been with XL Re for a considerable time. As Veghte outlined, “In Bermuda 60 percent of the premium from our US property catastrophe portfolio is from customers that we engaged with in our first year of operations in 1992–1993. Those relationships are critical to us and will be key as we position ourselves going forward.” Delivering third party capacity will undoubtedly form part of XL Re’s efforts to deliver lasting value to these clients.

*“We continue to believe in our ability to navigate a course through individual transactions and market trends in order to optimise our portfolio.”*

## In pursuit of opportunity

Turning to rising insurer retentions, Veghte said that they represented “a challenge both to XL Re and to the wider market, but we continue to believe in our ability to navigate a course through individual transactions and market trends in order to optimise our portfolio”. Veghte said that rising retentions had been a feature of the market for the past 15 years, particularly as gross capacity has failed to keep pace with the strengthening balance sheets of primary players. Reflecting on the trend, Veghte said: “We have always encouraged our clients to keep a healthy retention on their business—it reinforces the value of our underwriting discipline and reinforces our relationship.”

Veghte added that opportunities nevertheless remain—to partner with primary players in emerging markets where the need for reinsurance capacity is more marked, and with insurers in more mature markets through the use of both traditional and convergence capital. Addressing emerging market opportunities, he described the trend towards rising retentions as “less pronounced” in such markets, with local companies “employing reinsurance as both a financing vehicle and a risk management tool”. Smaller, more local insurers in such markets simply don’t have the balance sheet to absorb additional retentions, Veghte explained, and as such they tend to place great store in reinsurance as a backstop to their operations.

Demand for reinsurance in emerging markets presents considerable opportunities for XL Re, particularly as the company expands and leverages its global footprint. Veghte said that as an early entrant in a number of key markets—in Brazil in Latin America and Singapore in the Asia Pacific—opportunities exist to build lasting relationships such as those XL Re has established with US clients over two decades of operations. Experience has shown that an ability to be early to market can be beneficial said Veghte, with XL—through its insurance and reinsurance platforms—making early moves into a number of key markets.

The company’s global insurance network provides XL Re with a sizeable platform to access business globally, with the insurance and reinsurance arms working in close concert to explore the potential of emerging market business and “develop the most effective local footprint”, said Veghte.

Not that XL Re sees potential only in emerging markets. “If you look at the property catastrophe space internationally, increasing



Martin Sellier

insurance penetration, macroeconomic growth, increased values and enhanced modelling capabilities are all features of the landscape. I see an attractive long-term growth pattern for property catastrophe,” said Veghte, with the reinsurer looking to respond to opportunities as they emerge.

“We have never been terribly focused on top line or market share; rather we are focused on consistent underwriting and an ability to move quickly to deploy capital in the most profitable sectors of the market. In 2005 property catastrophe was around 12 percent of XL Re’s global premium, today it exceeds 25 percent. That is because we were able to shift the portfolio very quickly, out of long tail markets and into short tail business as relative profitability changed.” It is this flexibility and dynamism—by both line and geography—that will serve XL Re well as it pursues opportunities in the face of new market dynamics.

In its pursuit of premium XL Re is more than willing to “significantly shift its portfolio in response to market change”, with the company well positioned to take advantage of profitable opportunities in new and existing markets as, and when, they emerge. Helping to facilitate entry and development is the company’s dual platform structure, “which enables XL Re to move from market to market and shrink or enlarge the portfolio according to market conditions”, while XL Re’s partnership with XL’s insurance operations provides it with the capital and operational flexibility to be selective in its pursuit of opportunities.

This flexibility is further enhanced by the reinsurer’s flat management structure that sees Veghte personally involved in individual underwriting decisions right across XL Re. Backed by a web-based pricing system that delivers consistent pricing principles globally, the reinsurer benefits from a level of “transparency in the underwriting process that has been critical to our success. We are able to monitor rate adequacy levels right across the market—by line and geography”—

enabling XL Re to develop its offering according to local conditions and pricing. And with a significant global footprint, XL is in a position to explore more potential opportunities than most.

## Future dynamics

Looking ahead, Veghte said that XL Re “continues to position itself for growth”, although it is evident that it will be pursued only when appropriate opportunities arise. He said that over the past eight years the company has delivered a combined ratio of 85 percent and been a “huge provider of profit to our shareholders”. The expectation is that this will continue, with the reinsurer’s discipline having been central to its delivery of such strong results. Veghte said XL Re’s focus on talent development, which had seen senior talent rise through the ranks, has helped it deliver such strong levels of performance, adding that it was through the nurturing of talent that the company would develop and deliver value going forward.

Veghte said that the company will continue to distinguish itself through innovation, leveraging new structures such as its venture with Stone Point and existing underwriting and market expertise, in order to respond to a fast-changing market environment. Veghte said that he expects the market will “move away from the classic, heavily syndicated distribution model, to much more bespoke, private layer-type arrangements, which we have begun to see in the catastrophe space in recent years. In this environment, product innovation is going to be critical to those looking to distinguish themselves, with XL Re well-positioned to do exactly that”.

Emerging risks and market dynamics will create both challenges and opportunities for a company such as XL Re, but it is clear that Veghte and XL Re are ready to meet those challenges head-on as the company explores opportunities in an increasingly dynamic and global marketplace. ■