CATASTROPHE BONDS AND SIDE CARS

WHOSE RISK IS IT ANYWAY?

THE CATASTROPHE bond market emerged from the financial aftershocks to the insurance industry that followed the devastation wrought by Hurricane Andrew on parts of Florida and Louisiana in 1992. The insured losses resulting from that natural disaster topped $15.5 billion, a figure that rendered ten insurers insolvent overnight. Andrew left little doubt that such natural disasters could threaten the financial viability of the property casualty industry. Especially startling was the realization that had Andrew made landfall just a few miles away, insured losses would have exceeded $50 billion, the equivalent of 25% of the industry's capital base in 1992. Attorneys in our insurance and reinsurance, tax, capital markets, derivatives and securitization practices have worked with our investment bank and insurance company clients in structuring novel risk transfer transactions that have been instrumental in the development of this market from its inception.

In Andrew's aftermath, our clients' financial engineers soon observed that one solution to the vulnerable capital base of the property casualty industry was to obtain additional funding through the capital markets by appealing to potential investors seeking exposures uncorrelated to the conventional risks held in their portfolios. This observation quickly evolved into a flourishing practice as the insurance industry began to transfer catastrophe risk to the capital markets through various structured investment vehicles. From the early days of this evolving market, Morrison & Foerster attorneys have, in collaboration with our clients, worked on innovative capital markets instruments structured to achieve varying levels of reinsurance and risk transfer. Our attorneys have helped develop techniques and structures that allow an insurance or reinsurance company to access the capital markets to assure its ability to pay claims following the occurrence of catastrophic events. These structured reinsurance solutions provide an alternative to a tighter and more expensive reinsurance or retrocession market with reduced credit risk, thereby increasing insurance capacity and willingness to assume insurance risk. For investors, these structures provide an opportunity to diversify their portfolios and earn high risk-adjusted returns. Insured losses of $50 billion or even $100 billion amounts that would cripple the property/casualty industry are well within daily asset value fluctuations in the capital markets.

Our attorneys have participated in the full spectrum of transactions employed in the catastrophe bond, side car and insurance-linked securities markets, including indemnity, parametric, index and modeled, reinsurance and swap based structures, covering numerous risks and perils, whether U.S. domestic or offshore, single or multi-peril, one off or program-based. Many of these transactions represent the first of their kind, as to peril, structure, domicile, trigger and other structural aspects. By marshalling the depth of knowledge and experience of our insurance, reinsurance, capital markets, derivatives and tax practices, we are able to assist our clients in developing and implementing innovative structures that respond to opportunities presented by the complex intersection of the reinsurance and capital markets.