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31 May 2017

Blue Capital Alternative Income Fund Limited

Uncorrelated yield opportunity

Blue Capital Alternative Income Fund Limited (BCAI) helps insure the insurers, diversifying its portfolio across a range of potential catastrophes. This business is largely uncorrelated with traditional investment markets, so the fund offers investors alternative income with a yield of 6.5%. The return from inception to 31 March 2017 is 45.8% (9.1% a year). The shares trade at a discount to NAV of 7.8%. This is higher than most alternative income funds. BCAI's managers say the discount is unwarranted, given the strength of the opportunity and its strong and stable performance. They believe that the discount offers a good entry point.

LIBOR+8% target returns

BCAI aims to offer investors target returns of LIBOR+8% via a master fund (an underlying special purpose vehicle used to hold the investments), that invests in a broad range of reinsurance risks diversified by risk, geography and peril. It currently invests in just over 1,500 different contracts from a variety of customers. No one relationship currently supplies more than 36% of invested assets for the portfolio.

US-dollar returns

The reinsurance industry is a largely US-dollar denominated one and so the Fund's returns are earned in US-dollars. These returns are unhedged for sterling investors, who consequently face a currency risk. Despite this, BCAI has generated strong and stable returns, since inception, in sterling terms and, as the Fund's expenses are dollar denominated there is an element of internal hedging.

Period ended	Share price total return (%)	NAV total return (%)	1-month US$ LIBOR +8% (%)
30/04/13*	1.0	1.8	3.2
30/04/14	11.7	10.1	8.2
30/04/15	0.1	9.6	8.2
30/04/16	7.2	9.9	8.3
30/04/17	9.7	8.7	8.6

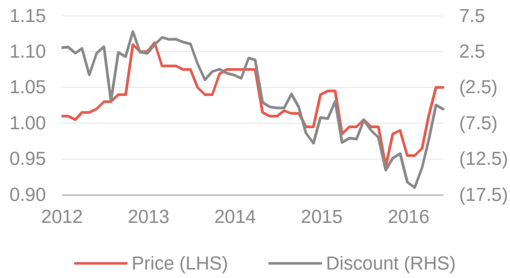
Source: Morningstar, Marten & Co *Note: period from launch on 6 December 2012.

Sector	Specialist-reinsurance
Ticker	BCAI LN
Base currency	USD
Price	1.02
NAV	1.1065*
Premium/(discount)	(7.8%)
Yield	6.5%

* as at 30 April 2017

Share price and discount

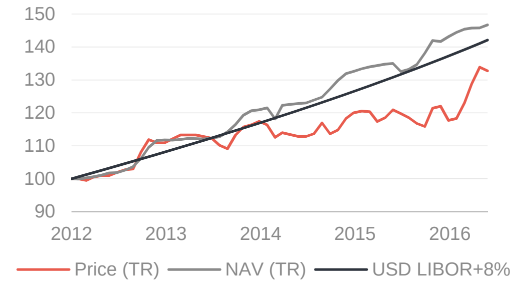
Time period 06/12/12 to 30/04/17



Source: Morningstar, Marten & Co

Performance since launch

Time period 06/12/12 to 30/04/17



Source: Morningstar, Marten & Co

Domicile	Bermuda
Inception date	6 December 2012
Manager	Blue Capital
Market cap (US$)	182.3m
Shares outstanding	178.7m
Daily vol. (1-yr. avg.)	343,701 shares
Net gearing	Nil

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Introduction

Uncorrelated with investment markets. More information can be found at the manager's website:

www.bluecapital.bm

BCAI, listed in both Bermuda and London, is one of just two listed investment companies focused on investing in catastrophe reinsurance risks. These risks are largely uncorrelated with traditional investment markets in that natural catastrophic events, such as earthquakes and windstorms, are not driven by the direction of investment markets. BCAI invests, via a master fund, in contracts originally underwritten by a variety of professional underwriters. This is managed by Blue Capital Management Limited. Sompo International, an insurance company now part of Sompo Holdings Inc (as of 28th March 2017), provides approximately 35% of the invested assets with the remainder sourced from a variety of insurance brokers. Reinsurance is an area of the market that is mainly a broker led segment. The global leaders are: Aon, Guy Carpenter, Willis and similar names.

BCAI has returned 45.8% cumulative since launch; 94.1% of months are positive returns

From launch in 2012 until the end of March 2017, BCAI has provided cumulative returns of 45.8%. The best single monthly return has been 3.2% and the worst -1.8%, with 94.1% of months showing positive returns.

The portfolio is well diversified, with over 1,500 positions in different reinsurance contracts.

The fund has a target return of LIBOR plus 8% with a targeted annual dividend of LIBOR plus 6%.

BCAI changed its name to Blue Capital Alternative Income Fund in early May 2017

Following shareholder approval at the AGM on 9 May 2017, the fund's name was changed to Blue Capital Alternative Income Fund Limited (previously Blue Capital Global Reinsurance). Management feels the new name better reflects the uncorrelated nature of the returns as well as the dividend yield.

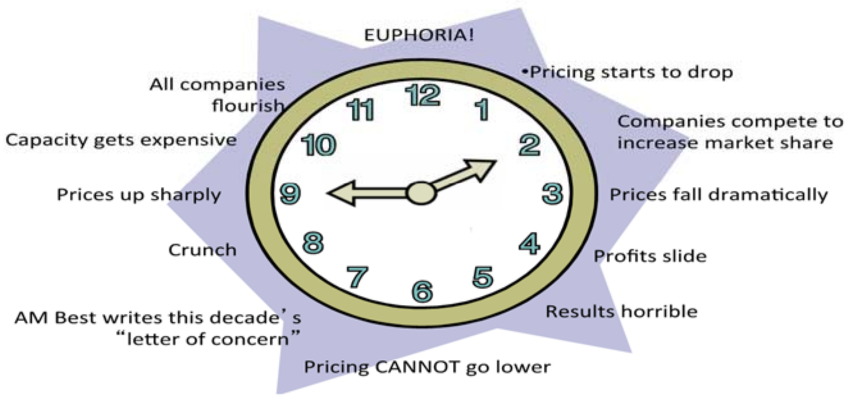
Market outlook

Insurance markets are well capitalised

Global insurance and reinsurance markets are influenced by cycles in capital availability. Periods in which there is surplus capital see pricing driven downhill until the point that the least efficient suppliers leave the market or a large market loss creates a capital deficit pushing prices up. The reinsurance market has seen rates (pricing) in most lines of business soften for the last three years. However, in a number of areas, the market appears to be approaching a floor as the rate of decline is slowing, with only modest rate declines experienced at recent renewal periods. The price of reinsurance is only part of the equation. The terms and conditions of the reinsurance contract often tend to favour the insured party in a softening market, inasmuch as more cover tends to be offered for the same price.

A useful means of illustrating the cyclical nature of insurance and reinsurance markets was described many years ago by Paul Ingrey who then worked at Arch Capital. He likened the pricing cycle to a clock and while the illustration below in Figure 1 is light hearted in nature, it is generally considered to be a good description of the behaviour of the market. In many recent cycles, some industry participants have pushed rates so low that they compete away their capital to the point where leading credit rating agencies, such as AM Best, voice serious concerns and start to downgrade companies.

Figure 1: The insurance clock



Source: Paul Ingrey

Insurance pricing tends to be cyclical

The sheer size and variety of the risks and risk carriers that comprise the market mean that there has been little or no academic research done in this area. Given this and the importance of the industry to individuals, corporations and governments as a risk carrier, insurance regulators have developed better capital monitoring models. Thus, the seven o'clock position on Paul Ingrey's clock is now less about the rating agencies becoming concerned and more about government regulators setting capital requirements designed to protect buyers. This has the knock-on effect of preventing the worst excesses of competition. Thus, while the ready availability of capital tends to keep the insurance pricing environment soft, the impact of global regulators means that investors should now be better protected than they have been historically.

Long term opportunity

BCAI's portfolio is much more diverse one than any single insurer could offer an investor

If you invest in an insurance company, you are exposed both to catastrophe risks and asset valuation risks (as insurance companies tend to come with large portfolios of assets). A key argument for investing in BCAI is that, in addition to offering returns that are less correlated with global investment markets, investors are able to gain direct access to catastrophe risks, a segment of the insurance industry that BCAI's managers consider to be attractive, without exposing themselves to the asset risks.

Insurance premiums typically grow in line with GDP and while this is modest, it is growth. Swiss Re estimates that non-life premium volumes grew 2.4% in 2016 and will grow 2.2% in 2017 and 3.0% in 2018. Furthermore, the fund (see below) acts almost like a fund of funds (a fund that makes investments in other funds) within the reinsurance space. This is unlike buying shares in an insurance company where the investor is just exposed to a single company's book of business. BCAI has approximately 35% of its invested assets in a single insurance company (Sompo International), as of 31 March 2017 but the remainder is in a variety of additional catastrophe exposures underwritten by the management. The portfolio is thus diverse but with varied exposures to catastrophe risks only.

Fund profile

A diversified fund with a focus on smaller insurers

Established in 2012, BCAI is listed in Bermuda and London on the Specialist Fund Market (SFM) as an investment company investing in catastrophe reinsurance contracts. The fund provides exposure to over 1,500 reinsurance contracts sourced from a variety of providers. This means that investors should get significant diversification of risk exposures. Furthermore, management focuses on smaller insurers that purchase significant amounts of reinsurance to meet regulatory requirements. This provides a number of potential advantages with the main ones being that these entities tend to be consistent buyers of reinsurance regardless of the price.

Key fund characteristics

Please see the appendix at the end of this document for some background information on reinsurance and the industry

- Investment policy: to invest in a portfolio of fully collateralised natural catastrophe reinsurance risks. These are diversified in terms of geography, perils (a specific risk or cause of loss, such as a fire, windstorm or flood) and events (for example Hurricane Matthew). Accessing these reinsurance risks is done mainly through the traditional reinsurance market. This market is a broker market in large part. An appendix at the end of this document offers some background on reinsurance and the industry.
- Target yield: LIBOR +6% per annum on the original issue price of the fund's shares (US$1.00 per share), paid quarterly.
- Target return: annualised portfolio target return, net of fees and expenses, is 1month LIBOR +8% over the long term.
- Market capitalisation: $182.3m as at 26 May 2017. Further equity issuance is targeted.
- Listing: Specialist Fund Market of London Stock Exchange (BCAI LN) and Bermuda Stock Exchange (BCAI BM).
- Manager's fees: management fee of 1.5% of NAV per annum falling to 1.25% over $300m. In addition, annual performance fees of 15% of returns over LIBOR +8%.
- NAV: monthly NAV publication.
- Leverage: none allowed for investment purposes.
- Anchor commitment (a large commitment that acts as a foundation to attract other investors): Endurance Specialty Holdings (NYSE ENH) has a strategic investment of $50m or 28% of outstanding shares.
- Manager: Blue Capital Management Limited, a wholly owned subsidiary of Sompo International.

Experienced management team

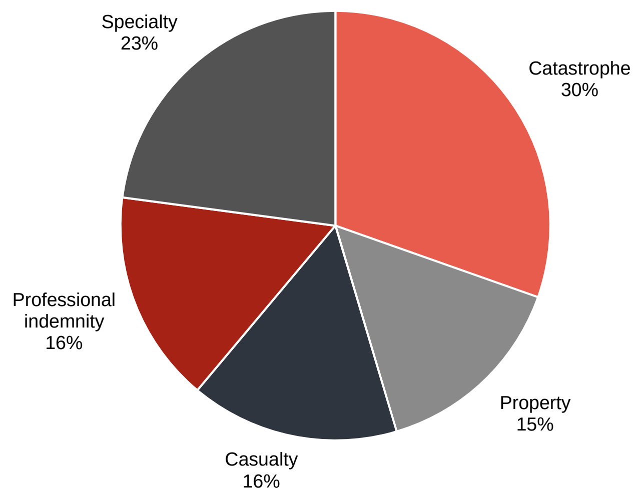
The fund is managed by Blue Capital Management Limited, with William Haddrell serving as portfolio manager. He is responsible for risk origination, underwriting and trading and has worked at Blue Capital since December 2013. Prior to his current role, he worked for Hardy Bermuda within the property treaty team as an underwriter with a focus on the USA and Japan. Prior to Hardy Bermuda, William Haddrell worked as an underwriter in the direct and facultative team at Renaissance Re's Syndicate 1458 at Lloyd's of London from 2010-2013 and as an underwriting analyst for Renaissance Re Bermuda from 2008-2010. He is assisted by a team of 25 professionals together with three experienced non-executive directors. Michael McGuire, the chief executive officer has extensive reinsurance industry experience and has been the CFO of Sompo International/Endurance Specialty Holdings Limited since 2006. Michael has replaced Adam Szakmary who was CEO of BCAI until he resigned from the investment manager with effect from 21 April 2017. The chairman, John Weale has experience as a chief financial officer in the insurance industry, Greg Hancock was a former senior KPMG partner and George Cubbon has a 30-year insurance industry career.

Relationship with Sompo International (formerly Endurance)

Sompo International provides approximately 35% of BCAI's invested assets as of 31 March 2017 and Blue Capital Management Limited, the manager of the fund, is a wholly owned subsidiary of Sompo International. In March 2017, Endurance Specialty Holdings Limited was acquired by Sompo Holdings Inc, one of Japan's largest insurers, and is now marketed under the name Sompo International. This deal is not expected to alter the relationship between the fund and its manager or Sompo International. Endurance is rated A+ by AM Best and A by Standard & Poor's (with a positive outlook). At the end of 2016, Endurance had shareholders' equity of $5.14bn (2015: $5.12bn) and it wrote $4.20bn of premiums in that year, representing a 26.5% year on year rise. The combined ratio (a measure of profitability for an insurance company that is typically expressed as a percentage, is the sum of incurred losses and expenses divided by the earned premium) achieved in 2016 was 88.1% (2015: 82.9%). The investment portfolio at Endurance is short term (the bond portfolio averages 2.66 years) in common with most property and casualty insurance companies and consists predominantly of AA rated debt instruments. As claims can take a number of months or even years to reach settlement, insurers set up reserves (put capital aside) for these by estimating what the final claim amount will be. In determining the size of the reserves it sets aside, it would appear that Endurance has been conservative (i.e. acted with caution and been generous in setting aside reserves). For example, it subsequently made a reserve release (reducing a reserve that has been put aside) of $221.6m in 2016 equating to 9.4 percentage points on the loss ratio of 55.9%. An even more favourable run off occurred in 2015 accounting for $243.5m helping the loss ratio of 46.4% by 12.3 percentage points. BCAI's managers think that this sort of performance should be sustainable as Endurance appears to have a well-diversified business split between insurance (60% of premiums) and reinsurance (40% of premiums). Drilling down into the make-up of both the insurance and reinsurance books shows a broad spread of business by both product and geography. Maintaining a spread is usually considered important when attempting to prevent an insurer from being significantly adversely affected by a single large market loss event.

The following exhibits illustrate the old Endurance (now known as Sompo International) business split in a little more detail. The first pie chart, Figure 2, shows the reinsurance business split by business line in 2016. Catastrophe reinsurance business is the largest segment at 30.4%, but there is a good spread. In recent years, there has been a focus on growing the specialty book and conversations with the managers suggest that this could continue to grow relative to other business classes. This could be important because the specialty book tends to be "stickier", better rated business and often has different rating cycles to more mainstream lines such as property. This portion of business written by BCAI is solely from Endurance's catastrophe book of business and is assumed on a quota share basis where losses are shared proportionately with the percentage of premiums written.

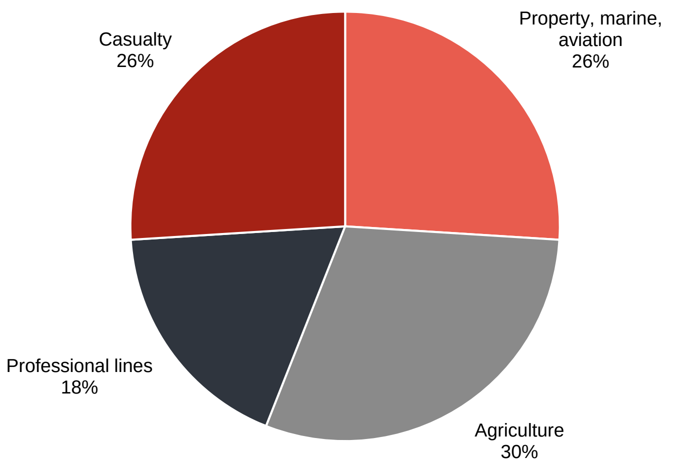
Figure 2: Endurance reinsurance split by business line 2016



Source: BCAI

Figure 3 shows Endurance's split by segment in direct insurance business. It is noteworthy that there is a good geographic spread of business and, all things being equal, this tends to be helpful in keeping aggregate exposures to market events down. Within Endurance's catastrophe book of business, the underwriting focus is predominantly on smaller regional clients, similar to BCAI's approach.

Figure 3: Endurance insurance split by business line 2016



Source: BCAI

Managers' view

The managers believe that the rationale for investing in BCAI is that:

- BCAI provides exposure to catastrophe reinsurance that is largely uncorrelated to financial markets and thus offers investors good portfolio diversification.
- BCAI offers an attractive return profile with negligible risk from financial assets.

- BCAI leverages Sompo International's operational support. Sompo International is recognised in the market as a global specialty insurer and reinsurer with strong historical financial performance.
- BCAI offers investors unparalleled direct access to a diversified portfolio of catastrophe reinsurance risks.
- The current discount to NAV offers an attractive entry point.

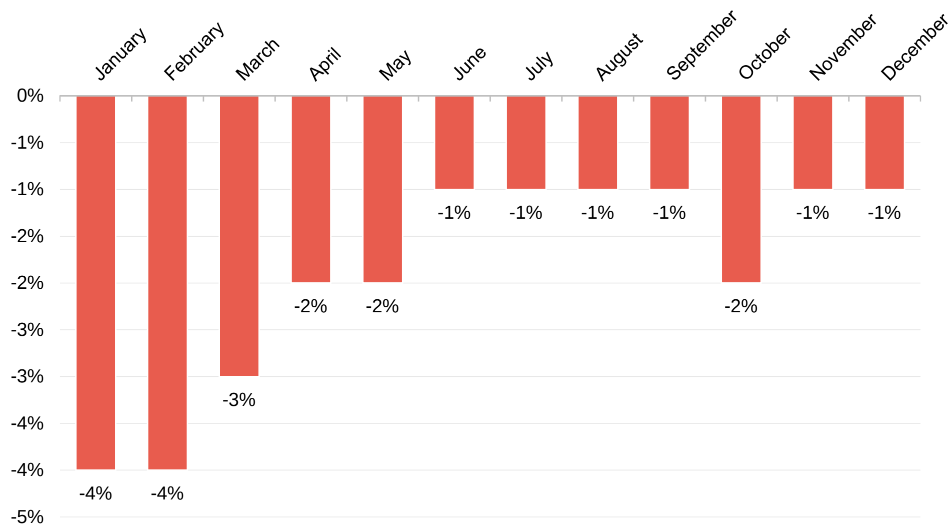
Near term view: outlook improving

Taking a near term view, the managers believe that reinsurance rates in a number of business classes have probably bottomed. In a low interest rate environment, the investment side of both insurers and reinsurers' businesses is delivering returns of no more than 2%. This means that when underwriting combined ratios (claims plus expenses expressed as a percentage of the premiums) near 100%, or exceed this, little to no profit is being made. Once the cost of capital is taken into account, significantly negative returns are being produced, which is not a sustainable position.

Reinsurance rate increases are hard to spot

Management thus expects rates in many lines of business to stop falling. Rate increases may be harder to spot, but BCAI's manager says that these are beginning to be seen in some geographies, especially those where loss events have occurred. The manager says that the headwinds of falling rates are starting to abate and, whilst rate cuts are still being seen, these have moderated to no more than a 3% reduction. Importantly, the manager says that pricing pressure is not uniform and that BCAI is addressing these challenges by focusing on its core clients as well as leveraging its relationship with Endurance. Given the size and variety of risks in the global insurance market, the visibility on premium rates is somewhat limited. However, Figure 4, which shows Market Scout's view of commercial property and casualty insurance rates in the USA in 2016 offers an illustration.

Figure 4: USA P&C insurance rates, 2016



Source: Market Scout

Investment process

Sompo International supplies 35% of the portfolio as a % of NAV

Reinsurance assumed from Sompo International supplied approximately 36% of BCAI's invested assets in 2016. This figure, which comprises quota share business, is mandated not to rise above 50% of invested assets. Endurance committed $50m of capital to establish BCAI and supplies some of its back-office functions. Aside from this, BCAI tends to seek out smaller, regional insurers as these tend to be more loyal clients due to their greater reliance on reinsurance than their larger, better diversified competitors. The reasons for this is that their limited ability to diversify means that smaller insurers need more capital and reinsurance provides this. These insurers range in size from just $25m of share-holders' equity to $500m, with the average sized client having $250m of equity. In terms of risks, the focus is primarily on residential risks as these are believed, by management, to be both more persistent as well as more predictable. BCAI's underlying risks are diversified across multiple smaller insurance companies. These insurance companies insure a geographically well spread book of property risks. The aim is to minimise a loss from a single large catastrophe event like a Florida hurricane. BCAI is also able to leverage the relationship with Endurance through being able to meet clients and brokers as they enter Endurance's office. BCAI underwriters will independently underwrite its business following meetings but the relationship with Endurance allows access to a greater number of potential clients.

Another consideration is that, while insurance and reinsurance markets are soft in rating terms, rates do not all soften uniformly.

BCAI aims to create a diverse portfolio of risks by carrier and geography so while it should not be significantly adversely affected by a large, single catastrophic event, such as a hurricane or earthquake, it seeks to minimise its exposures and diversify its risks. It believes that this, along with the highly transparent nature of the underwriting information it is able to access from the insurers it reinsures, is the way to create consistent above market average returns.

A feature of BCAI's approach is that it visits all the insurers it reinsures at least once a year and normally twice, enabling a relationship to be developed. It also helps the manager to build up a real understanding of the underlying risks. The manager says that this is key as it is adding underwriting capacity to the market. Most of the portfolio is what is known as first event property catastrophe cover. This is cover for the first wave of a catastrophe loss that an insurer bears rather than providing coverage for multiple events that occur within the same area during the contract period. Several competitors offer products that allow multiple losses during the contract period.

BCAI has a very different approach to others in the market

This approach contrasts with others in the market that target exposure through catastrophe bonds that are essentially industry loss based derivatives. These have low barriers to entry and tend to have binary outcomes. If all goes well, then investors receive their coupon payments and all their capital is returned at maturity but if the loss parameters of these securities are triggered, investors lose all of their capital as well as the coupon. Catastrophe bonds and other ILS (insurance linked securities) by their nature tend to be exposed to more complex, often volatile, commercial risks. These securities also tend not to distinguish between good underwriters and bad ones. After a large event that triggers a claim, there is no way of managing the claims process. This contrasts sharply with BCAI, which has a direct relationship with its insurers and is very much part of the claims management process. This can be important in maintaining long term relationships.

BCAI has no formal benchmark

Impact of large potential losses is modelled by BCAI

There are only two quoted funds in the reinsurance space and there is no obvious benchmark. Management targets between 6.4% - 10.4% returns on the underlying business underwritten. This has converted into a steady growth in the fund's NAV since inception as the following table illustrates.

Figure 5: BCAI NAV growth, %

Year	NAV growth, %
2013	11.8
2014	8.8
2015	9.6
2016	8.3

Source: BCAI

Potential large losses modelled

BCAI's manager has modelled the impact on the fund in the event of a large loss and this is illustrated here. The approach has been to take some of the largest catastrophic losses in history, revalue these and overlay the result on the portfolio. The portfolio will of course change over time so Figure 6 only offers a snapshot. This work also assumes that all else is equal, so the outcomes could be very different from those illustrated. The company says that it models continually, and at a sophisticated level, in order to manage risk and ensure that major catastrophes can occur without destroying the returns in many cases. Additionally, it needs to be appreciated that without the potential for economies to suffer large natural catastrophe losses, there would be a lack of appetite for customers to buy insurance or reinsurance.

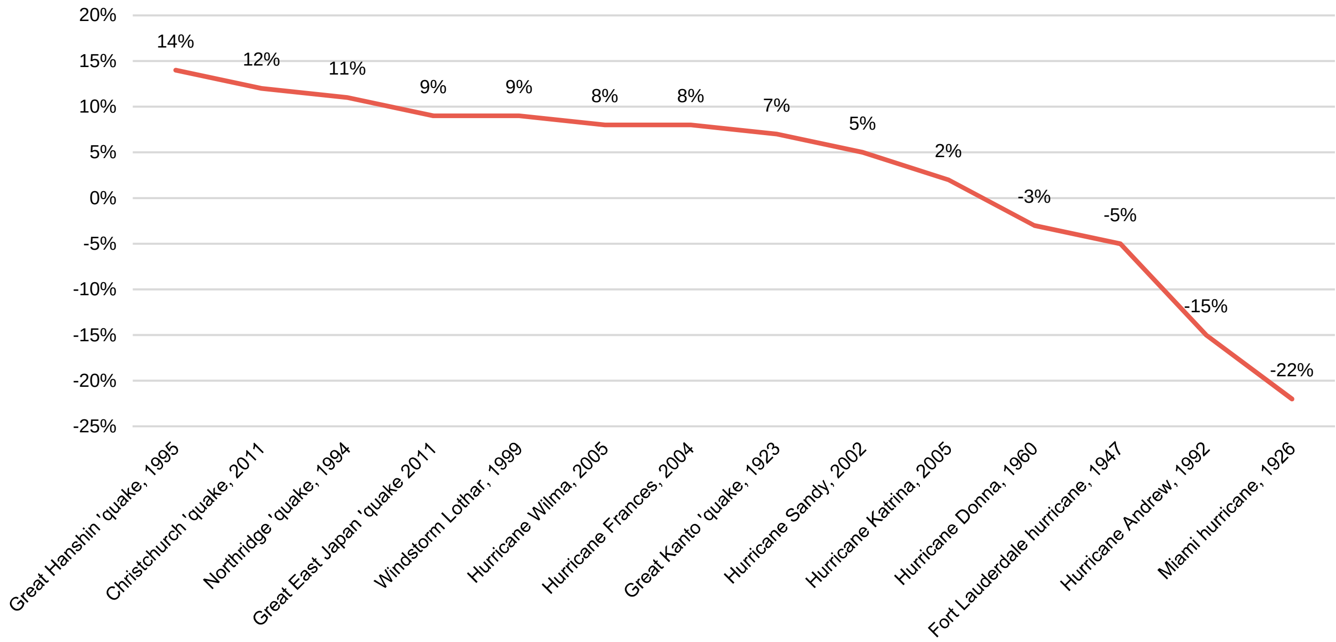
The modelled return in the event of no losses affecting the portfolio in 2017 is 14.2%

BCAI is now in its fifth year and has developed a proprietary methodology to develop its portfolio. Given that most reinsurance contracts are for one year only BCAI's manager says that this has been an essential tool to develop. Viewed from the top down, the over-riding aim of management is provide investors with attractive returns that are as uncorrelated with financial markets as is possible. The modelled return in the event of no losses affecting the portfolio in 2017 is 14.2%.

In addition to modelling the risks it underwrites, BCAI believes it differentiates its underwriting by:

- Targeting trading partners that have superior underwriting discipline and risk selection.
- Focusing on residential risks as these are more predictable than commercial risks that include potentially more complex losses.
- Ensuring the underlying risks are diversified across small, well run insurance companies in certain, targeted and very specific locations; a large market event like a Florida hurricane should have a manageable loss.
- Handling claims better to minimise the total pay-out.
- Insisting on the highest quality underwriting data that enables the underlying risk to be properly modelled.

Figure 6: Indicative return on NAV in large single event loss scenarios modelled at 1 January 2017

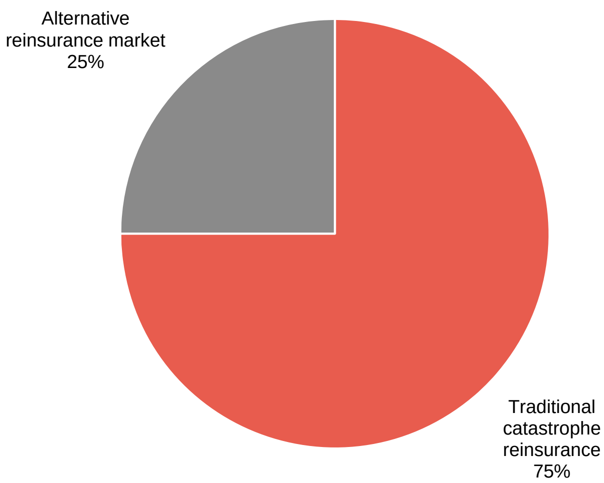


Source: BCAI

Diversity is key

BCAI's manager says that a key element of executing this strategy is to build a diverse portfolio of risk both geographically and by insurer. BCAI accesses the traditional catastrophe reinsurance market via its own team as well as through its direct relationship with Endurance. Management estimates the size of the global catastrophe market for property risks to have an annual premium volume of $375bn. It further believes that circa 90% of the entire market is potentially available to it, and says that not all these opportunities would be available to some stand-alone reinsurance fund managers. The manager says that BCAI's collateralised reinsurance capability further opens its opportunities. The strategic focus is on the largest segment of the market: traditional catastrophe reinsurance. In terms of premium volume, 75% of the whole market remains traditional reinsurance as Figure 7 illustrates.

Figure 7: Reinsurance market split



Source: Artemis

With a view to ensuring a good spread of investment risk, the portfolio is divided into 21 geographic regions as illustrated in Figure 8.

Figure 8: Portfolio geographic regions

North America	Europe	Rest of world
Northeast	UK and Ireland	Middle East
Mid Atlantic	N Europe, Benelux, Scandinavia	Australia
Florida	West Central	New Zealand
Gulf	W Europe	Japan
New Madrid	S Europe	S America
Midwest	E Europe	
California		
Hawaii		
Canada, East		
Canada, West		

Source: BCAI

The probable maximum loss from any one catastrophe loss event, in a one in a hundred-year period, is not expected to exceed 35% of the fund's net asset value

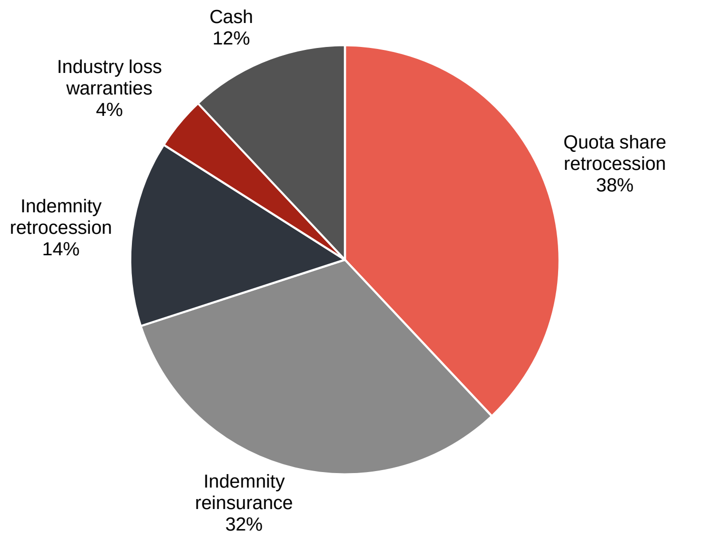
The total exposure in any one zone is limited to 50% of the Fund's NAV. The zone is taken to mean not only the geographical location, but also the peril and occurrence characteristics. In addition, the probable maximum loss from any one catastrophe loss event, in a one in a hundred-year period, is not expected to exceed 35% of the fund's net asset value. In terms of earthquake exposure, the probable maximum loss is limited to 35% based on a one in two-hundred-and-fifty-year return period. Further, no more than 20% of the fund's NAV will ever be invested in a single catastrophe linked contract or security. In pricing terms, the fund will not invest in anything with a premium of less than 5% of the limit exposed to a single event. These restrictions will be monitored continually as the portfolio develops to ensure that no new investment is made that might cause a breach of these rules. The Fund will buy retrocessional cover (see page 23 for explanation) as the managers see fit.

The fund cannot borrow for investment purposes. However, borrowings can be made to fund working capital requirements but only to a maximum of 10% of the fund's NAV.

Asset allocation

To illustrate how the above rules work in practice, Figure 9 shows the BCAI portfolio by asset class. It can be seen that the largest area of business is quota share retrocession closely followed by indemnity reinsurance. The latter is the most traditional form of reinsurance with the highest levels of transparency. The former, quota share contracts, see the reinsurance company work "hand in glove" with the reinsured so even though the BCAI exposure is retrocession, it is likely to have more insight into the business than if it were underwriting on an excess of loss (XoL) basis.

Figure 9: BCAI portfolio by investment type March 2017

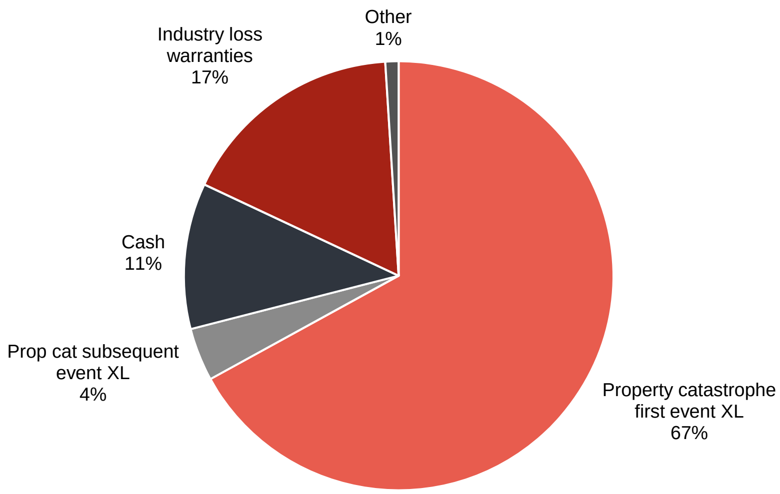


Source: BCAI

> 67% of portfolio is first event property catastrophe business

Looking at the portfolio another way, by contract type as in Figure 10, it can be noted that 70% of the business is first event property catastrophe excess of loss reinsurance. This is the area where the manager has traditionally had high, if not the highest, transparency of the original risk. As part of the investment process, there are imposed limits on how much of any given class of business can be invested in. Up to 100% can be in indemnity reinsurance. Moving away from straight forward reinsurance, no more than 50% of the fund's net assets can be invested in indemnity retrocession contracts, the same limit applies to quota share retrocession agreements and industry loss warranties (ILWs). Finally, only up to 10% of net assets can be exposed to catastrophe bonds or other non-property catastrophe risks.

Figure 10: BCAI portfolio by contract type 2016



Source: BCAI

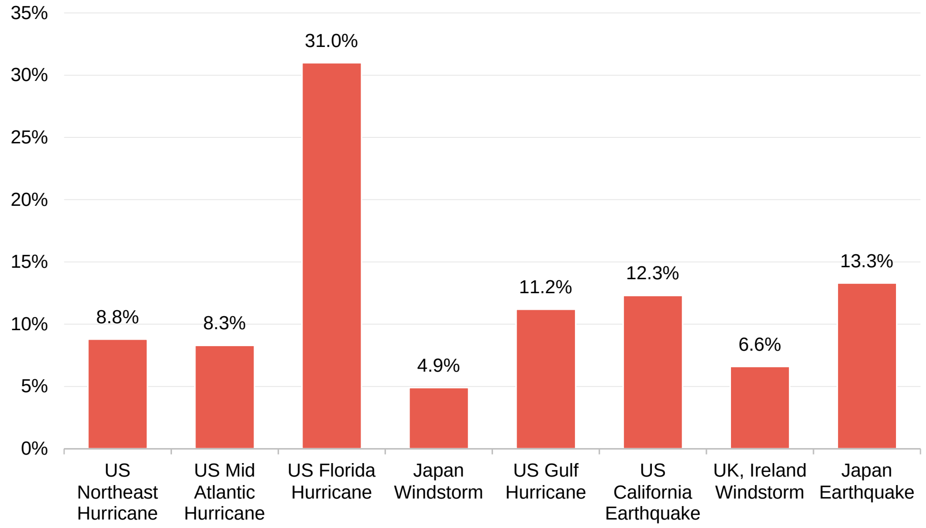
Portfolio risk characteristics

BCAI's manager says that using the modelling techniques available to a reinsurer mentioned above allows perspective as well as a lot of transparency around the nature of the risks they underwrite. BCAI uses these techniques via its own models as well as utilising third party modelling capabilities from AIR Worldwide. The latter is reportedly a market leader in catastrophe modelling techniques across the world.

High values at risk in Florida pose potential challenges

The upshot of all this is that BCAI's manager says that it can accurately model the probable maximum loss (PML) BCAI is exposed to in the event of a Florida hurricane, a Californian earthquake or a Japanese windstorm, for example. The next exhibit illustrates the modelled probable maximum loss BCAI expects to face in the event of the variety of natural catastrophe events its portfolio is exposed to. This is expressed as a percentage of the fund's NAV. The modelled loss severity is for a one in a hundred-year event apart from earthquake exposures where the modelling is for a one in two-hundred-and-fifty-year event. These are perceived as extreme outcomes. Increasingly regulators around the world insist that insurance companies demonstrate that they can withstand such extreme events and remain functionally solvent. As a consequence, many smaller insurance companies have felt obliged to buy increasing amounts of reinsurance cover. This is arguably good news for BCAI in that it has increasing choice in terms of the companies it reinsures and those it does have a good grasp of their underlying exposures. Increasing demand also tends to push up rates. Smaller insurers that are told by their regulators that they must buy certain covers/levels of cover are not as price sensitive as larger insurers.

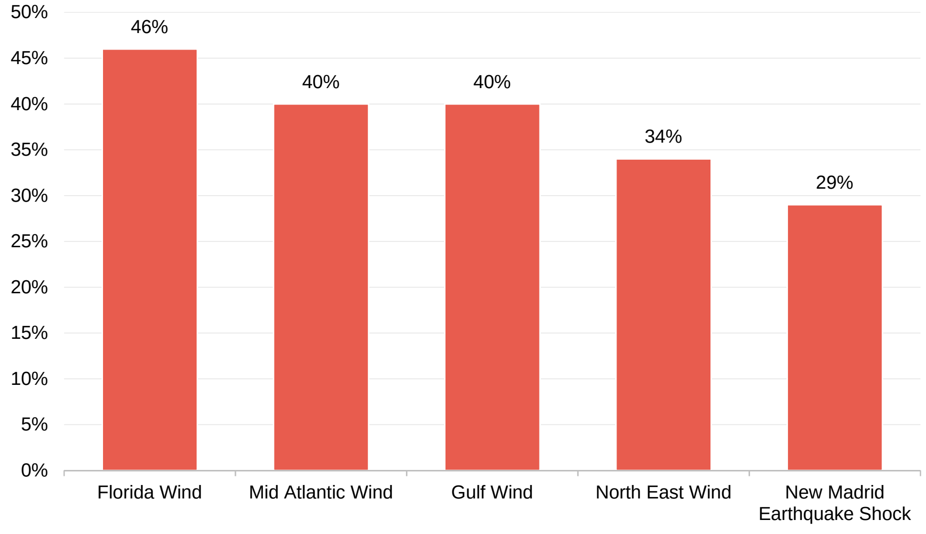
Figure 11: PML as % NAV modelled at 1 January 2017



Source: BCAI

It can be seen that, according to its model, a large hurricane hitting Florida would inflict the most damage on BCAI's NAV. This is a reflection of the potentially high aggregate values of properties exposed to damage by a severe hurricane and the readiness of market participants to buy cover. This is an insurance market phenomenon in the USA. Reinsurers thus need to exercise caution that they do not become over exposed to Florida from having an unhealthy aggregation of insurance companies in the State. The fund has an underwriting exposure limit of 35% for any one part of the world so Florida remains within these limits. The company believes that Florida is currently the best priced risk area in the world so the large exposure reflects this belief. BCAI's manager says that it monitors these aggregates carefully and these are illustrated in the next exhibit. It shows the total aggregate limit exposed to a first loss event. The first loss event describes the losses that occur and are claimed for immediately after a natural catastrophe has struck. The importance of this is potentially twofold. First, BCAI understands what its aggregate exposures are and two, those exposures are below 50% suggesting a more conservative approach.

Figure 12: Aggregate exposures

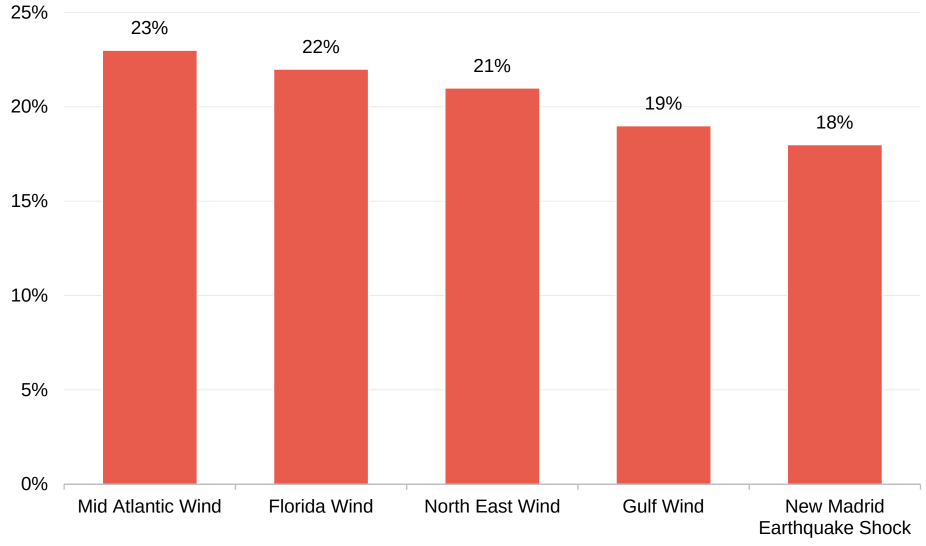


Source: BCAI

Aggregate exposures carefully monitored

Drilling down a bit further, BCAI monitors the split of these aggregate exposures by contract type. The most important of these is arguably the exposure that comes via quota share treaties. As was illustrated above under the heading "Asset allocation", 39% of the portfolio is in quota share treaties. These contracts are important because the reinsurer (in this case, BCAI) takes a fixed percentage of both the premiums and losses in a particular portfolio. Unlike an excess of loss contract where the reinsurer agrees to pay excess of an agreed dollar amount up to a certain limit, a quota share treaty does not have attachment points or limits expressed in this way and exposure can potentially aggregate quickly if this is not properly monitored. BCAI's manager says that it watches this carefully and the following chart shows the aggregate exposures that come from quota share treaties. These exposures are included in the previous exhibit's aggregate exposures.

Figure 13: Quota share aggregates



Source: BCAI

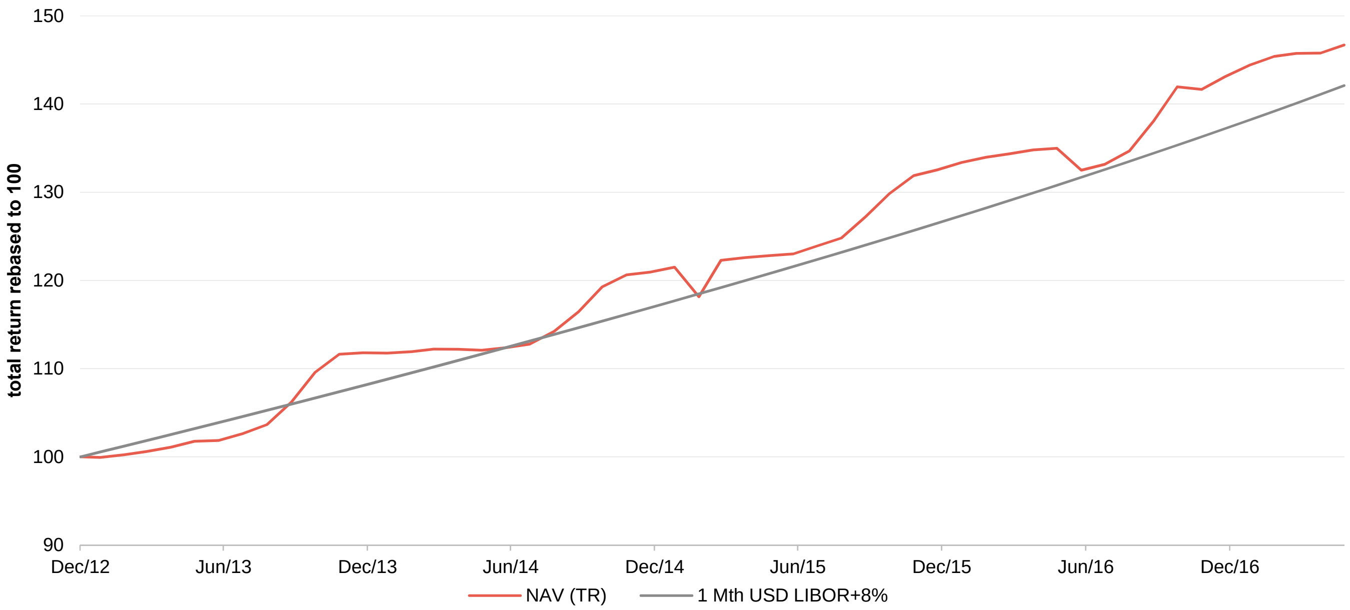
Performance

As Figure 14 shows, BCAI has more than matched its 1 month US dollar LIBOR +8% per annum performance objective since its inception. This despite being hit by a variety of catastrophes, including a 3.4% reduction in returns over the course of 2016 as a consequence of:

- Hurricane Matthew -1.6%;
- Canadian wildfires -0.7%;
- US hailstorms -0.5%;
- Netherlands hail storms -0.3%;
- Typhoon Meranti -0.2%;
- and Japanese earthquakes -0.1%

The manager says that 2016's loss activity was the largest since 2012.

Figure 14: BCAI NAV total return versus benchmark since launch



Source: Morningstar, Marten & Co

Peer group comparison

Please click here to visit QuotedData.com for a live comparison of BCAI and its insurance and reinsurance peers

There are only two quoted companies in this area. The other business operating in this space is CatCo Reinsurance Opportunities Fund (CATCo). However, there is one significant difference between CATCo's strategy and that of Blue Capital in that CATCo only invests in retrocessional reinsurance. It does not seek to offer reinsurance capacity in the way that is a major part of Blue Capital's investment approach. BCAI also invests in retrocession business, but this is part of a blended approach. As retrocession reinsurance is the reinsurance of reinsurers, there is less transparency of the original, underlying risk. This can make investing in retrocessional business potentially more risky. The potential capacity of retrocession business means that great care needs to be taken to avoid taking on additional exposures that might push aggregates, in some areas, beyond desired levels. For this reason, an investor in this area would generally require a higher return than that available in the reinsurance or direct insurance market.

Figure 15: Peer comparison

	CATCo	Blue Capital
Launch date	2010	2012
Domicile	Bermuda	Bermuda
Listing	London, Bermuda	London, Bermuda
Structure	Closed ended investment co	Closed ended investment co
Reporting	Monthly NAVs	Monthly NAVs
Calendar year	December	December
Target distribution	LIBOR+5%	LIBOR+6%
Target annual gross return	Libor+12%-15%	LIBOR+8%
Management fee	1.5%	1.5%
Performance fee	10%	15%
Performance trigger	LIBOR+7.5%	LIBOR+5%
High water mark	Yes	Yes
Continuation vote	Every 5 years	
Ticker	CAT.LN	BCAI.LN

Source: BCAI

Figure 15 offers some comparisons between the two funds. It is noteworthy that CATCo aims for a higher annual return, which arguably reflects the higher risk of its investment strategy. The annual returns are shown in the next exhibit. While CATCo has delivered higher returns since inception it can be seen that there has been greater volatility.

Figure 16: Percentage annual returns on NAV

Year	CATCo	Blue Capital
2012	-4.32	N/A
2013	21.90	11.80
2014	17.08	8.80
2015	11.58	9.60
2016	8.12	8.30

Source: Morningstar, Marten & Co

The average return since inception delivered by BCAI has been 9.6% and 10.8% at CATCo. It would appear that BCAI's strategy, of investing in both retrocessional reinsurance and reinsurance with some ILS exposure, has enabled it to generate steady returns. It has also helped it to develop a presence in the reinsurance market that could be useful in generating business going forward. CATCo, in contrast to BCAI, has focused on retrocessional reinsurance and at the high severity low frequency end of the market. In recent years, this has paid well but conversations with BCAI's manager suggest that rates have been under significant downward pressure. Enthusiasm by buyers for this sort of cover may now be waning although a large market loss event could rekindle appetite in this area of the market.

Premium/discount

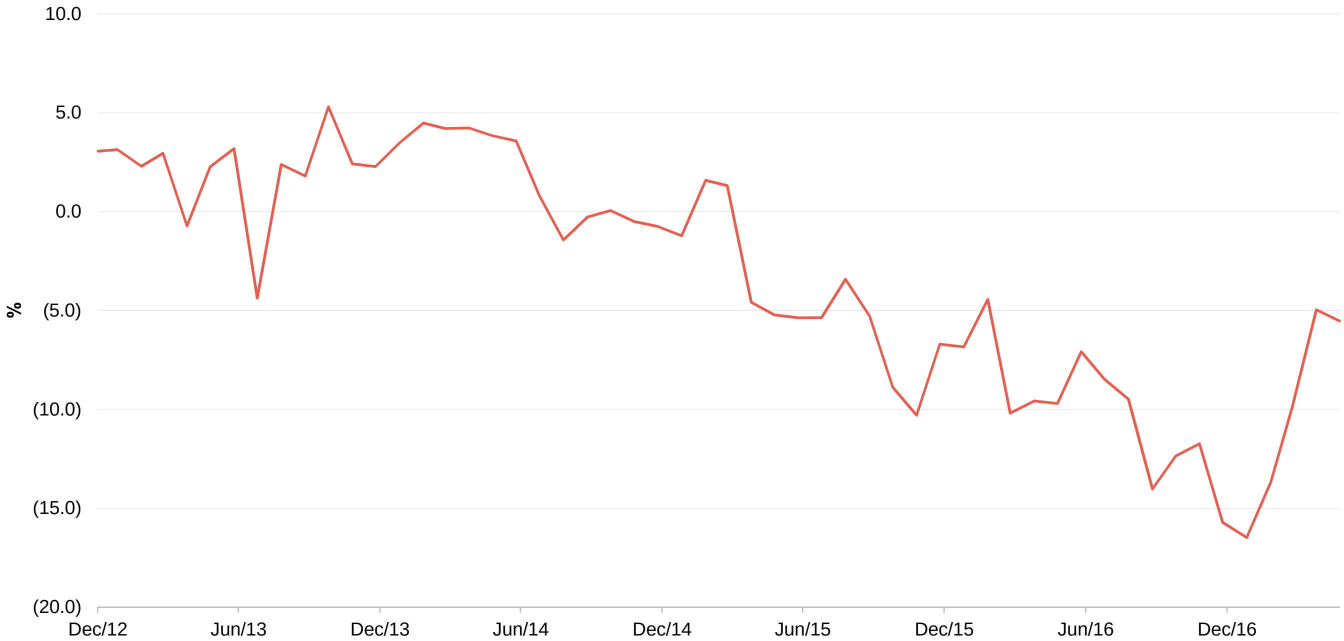
Figure 17 shows the premium/discount of the share price to NAV. The discount widened in 2014 at a time when the then parent of Blue Capital Management Limited was going through a sales process, which created uncertainty regarding the direction of BCAI. After Endurance purchased BCML, the CEO was replaced which also created some further uncertainty. Despite these changes, BCAI has consistently achieved its performance objectives. It may be that the discount reflects concerns about the inherent risks that the fund is exposed to and it is noteworthy that the discount narrowed sharply after BCAI announced its results for the year ended 31 December 2016.

BCAI has permission to repurchase shares from investors and has tasked its broker, Stifel, to effect share repurchases on its behalf. During the year ended 31 December 2016, 555,000 shares were bought back and cancelled.

In addition, as the shares traded, on average, at wider than a 5% discount over the three months ended 31 August 2016, the company implemented a tender for up to 10% of the then shares in issue. See the Capital Structure section on page 20 for more details.

The long-term trend arguably reflects the degree of concentration within the share register (see Figure 19 on page 21). A couple of handfuls of institutions own the bulk of shares in issue. When one of these sells, as Prudential M&G has been doing in recent months, this has a disproportionate effect on the share register. BCAI's board recognises that part of the problem has been that the company is not sufficiently well known and understood. Their intention is that, through education, the discount narrows to a level where the fund can re-expand.

Figure 17: BCAI premium/(discount) since launch

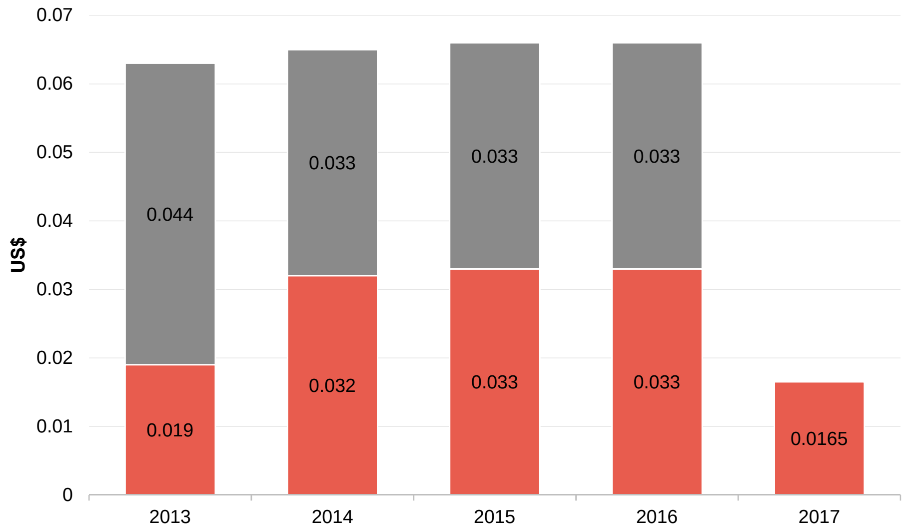


Source: Morningstar, Marten & Co

Dividends

The dividends paid since the Fund's inception can be seen in Figure 18. These have historically been paid twice a year in January and July. However, from this year, dividends will be paid quarterly. It is important to note that since inception BCAI has consistently paid dividends to shareholders.

Figure 18: Dividend record, US$



Source: BCAI

The rate of quarterly dividend announced for the first quarter of 2017 would, if maintained, match the total dividend paid in 2016.

Fees and costs

The management fee for the fund is 1.5% of net assets per annum. This would fall to 1.25% for NAV over $300m. There is also a performance fee payable triggered by a high-water mark and the hurdle is LIBOR + 5%. The trigger for the performance fee to be paid is LIBOR +8%. The Fund's target return is LIBOR +8% as mentioned above and, for the sake of clarity, since December 2012 inception the Fund has hit this target achieving a total return on NAV of 11.8% in 2013, 8.8% in 2014, 9.6% in 2015 and 8.3% in 2016. This suggests that while the target is achievable, it is a challenging one.

Administration services

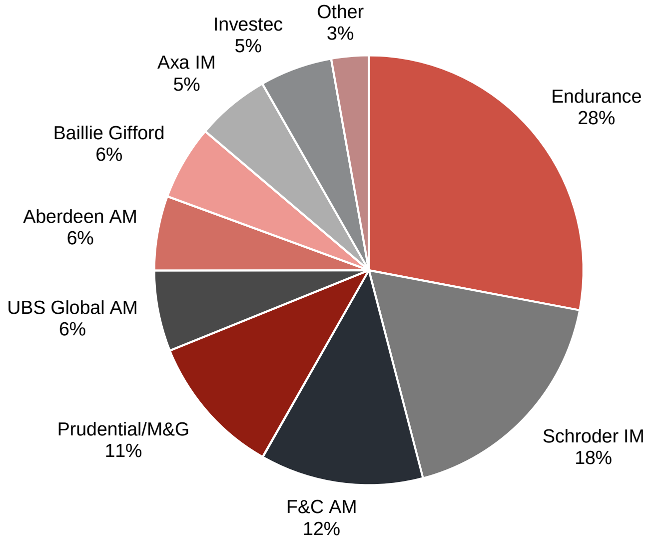
The administrator to the Fund is SS&C Fund Services, Bermuda limited. The administrator is paid per annum for both secretarial services and all other administrative services. These were charged at a rate of US$223,000 for the master fund in 2016. The company paid a sum of US$66,000 in the same year for its discrete administration services from the same provider. The administration services contract is subject to a termination clause allowing either side to terminate given six months' notice.

Capital structure and life

BCAI has two classes of share in issue (ordinary shares and redemption shares). The ordinary shares are listed on the Specialist Fund segment of the London Stock Exchange and the Bermuda Stock Exchange. There are 178,698,523 ordinary shares in issue with none held in treasury.

Sompo International maintains a $50m anchor investment in BCAI equivalent to approximately 28% of the share capital.

Figure 19: Major shareholders



Source: Bloomberg, Marten & Co

Borrowing

BCAI is allowed to borrow 10% of NAV for corporate purposes but is not allowed to gear up for investment purposes. It has undrawn facilities of $20 million. The Fund currently has no gearing.

Life

BCAI has an indefinite life and does not hold regular continuation votes.

Regular tender offers

As part of its efforts to control its discount, BCAI operates a discount triggered tender each year. The last of these was triggered by the discount trading, on average, wider than 5% over the three months ended 31 August 2016. Up to 10% of the shares were available for tender, 19,855,391 shares, and the tender was taken up in full. Each share validly tendered was converted into an unlisted redemption share. The company set out a timetable for the redemption shares such that:

- 58% was anticipated to be redeemed on 31 March 2017 for settlement 30 April 2017;
- 30% is anticipated to be redeemed on 31 August 2017 for settlement on 30 September 2017; and
- 12% is anticipated to be redeemed on 31 December 2017 for settlement on 31 January 2018.
- On 21 March 2017, the company announced that on or before 30 April 2017, an amount equal to US$13.1m will distributed to redemption shareholders.

Board

The BCAI board of directors comprises three non-executive directors and two executive directors. The management of BCAI is led by CEO Mike McGuire, Portfolio Manager, William Hadrell and Allison Kiene, the Chief Compliance Officer. Directors' fees are paid by the master fund and are not disclosed separately by BCAI.

The chairman has a significant breadth of experience in the insurance industry

The chairman is John Weale who is a certified Management Accountant whose previous executive roles have included being CFO at Catalina Holdings, IPC Holdings and various executive roles at AIG, Bermuda. BCAI's manager believes that this represents a significant breadth of experience in the insurance industry. Greg Haycock acts as BCAI's audit committee chairman. His experience as a senior partner at KPMG between 1985-2006. This included a focus on offshore financial services businesses. The third independent director is George Cubbon. He has over 30 years' insurance industry experience. This has included being CEO of AIG, Bermuda as well as a variety of other senior executive roles.

Figure 20: Board member - length of service and shareholdings

Director	Position	Date of appointment	Length of service (years)	Share-holding*
John Weale	Chairman	5 November 2012	4.6	34,950
Gregory Haycock	Audit chair	5 November 2012	4.6	5,000
George Cubbon	Independent	9 July 2015	1.9	5,000

Source: Marten & Co *Note: shareholdings taken from annual report for the year ended 31 December 2016 and updated as per most recent company announcements as at 30 May 2017.

Appendix

What is reinsurance?

A risk and capital management tool

Reinsurance is the major risk and capital management tool available to insurance companies. Reinsurance is simply insurance for insurance companies. The reinsurer agrees to indemnify (compensate for harm or loss) the insurer for all or part of a loss it has sustained. This puts the insurer in the same position as it was before the loss.

Insurance companies will attempt to diversify their portfolios by type of risk as well as geography. In some instances, a satisfactory level of diversification may not be available to an insurer. If the company operated as a property insurer in an earthquake prone region or was just a regional player only operating in a single State or geographical area, its ability to underwrite business would be restricted. This is where reinsurance comes in; the insurer will assess how much risk it should safely underwrite and offer the remainder to the reinsurance market.

Reinsurers work in partnership with insurers and provide cover for a wide variety of risks that get insured. Typically, an insurance company will get capital relief from having reinsurance; most country regulators will allow reinsurance to count as capital for solvency purposes and it is listed as an asset in the balance sheet. Reinsurers often help insurance companies with risk management and portfolio modelling. This also helps insurance companies develop and fine-tune the products they offer to commercial clients and individuals.

In the same way that insurance is a promise to pay future claims as these occur, reinsurance makes the same promise to its client insurance companies. In order to achieve this, a reinsurer will develop sophisticated risk management and modelling skills. These enable it to ensure it has enough capital to meet its obligations. Reinsurance is a global business and having a diverse portfolio of insurance company risks is key to sustained success.

Reinsurers in their turn often buy their own reinsurance and this is called retrocession reinsurance. Reinsurers can be either traditional reinsurance companies such as Swiss Re, Munich Re, SCOR, Hannover Re or companies such as Blue Capital. Reinsurance may be either traditional or collateralised (with collateralised reinsurance, assets are set aside, segregated from other assets, that are readily accessible in the event of a loss but with a pre-negotiated release of back to the market if there are no losses or if loss development is less than the contract limit).

The latter is reinsurance that is generally fully collateralised by third party capital providers such as investors or other third party capital providers. The full amount of the reinsurance contract limit minus the net premium charged for the protection is usually collateralised. This opens the reinsurance market directly to a variety of investors such as hedge funds, pension funds and other investment vehicles.

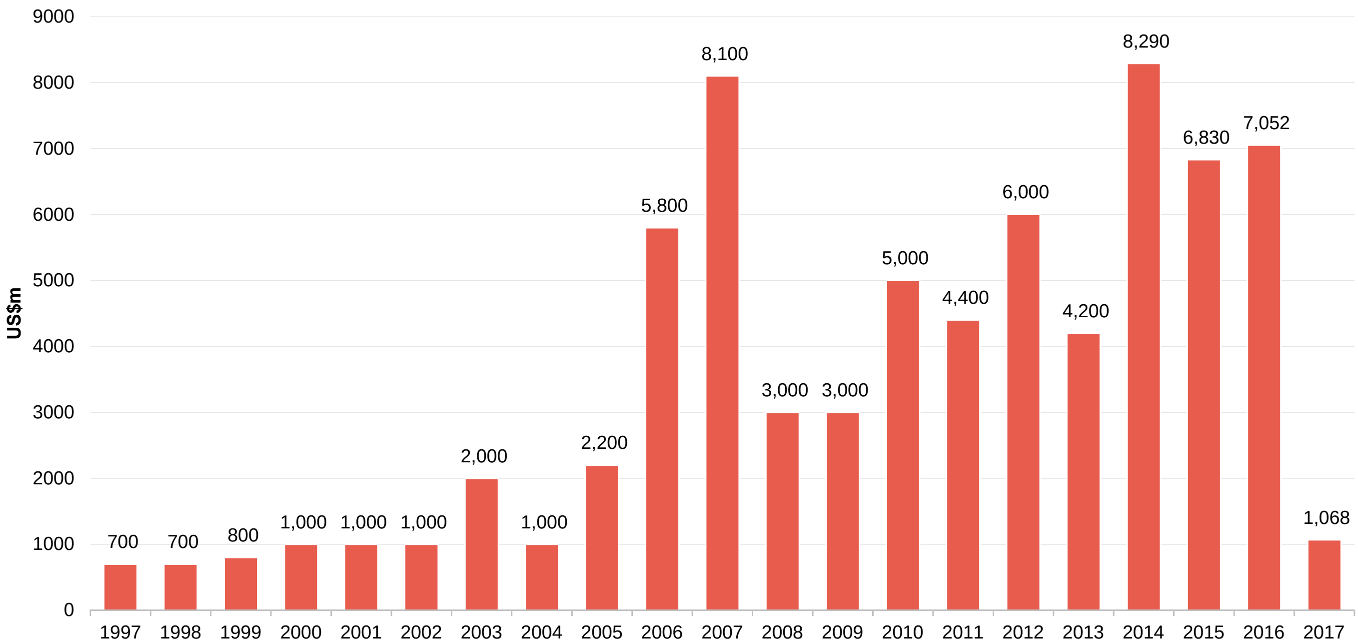
The reinsurance contract may be for all or part of a loss sustained by the insurer for which the insurer will have paid a premium. The insurer discloses as much information about the business being reinsured to its reinsurer as it is able; full, transparent disclosure should define the relationship.

Alternative reinsurance

In addition to traditional reinsurance and collateralised reinsurance there are other reinsurance products such as Industry Loss Warranties or ILWs, catastrophe bonds and retrocession. BCAI focuses on traditional reinsurance and collateralised reinsurance. Its manager says that the reason for this is that these forms of reinsurance offer good levels of transparency of the underlying risk whereas ILWs, catastrophe bonds and retrocession reinsurance often have a more opaque view of the original risk being covered.

Until recently, the only way an investor could gain exposure to the reinsurance market was via the quoted reinsurance companies. However, BCAI is one of two investment trusts offering an exposure to the reinsurance market, the other being CatCo Reinsurance Opportunities Fund (CATCo). The only other way of gaining exposure is by investing privately in a catastrophe bond or another form of insurance linked security (ILS). The opportunities to invest in ILS are relatively limited, investor access is not straightforward and such investments would appear to warrant high levels of investor due diligence. Putting this opportunity in numbers the next chart illustrates annual ILS issuance.

Figure 21: ILS issuance



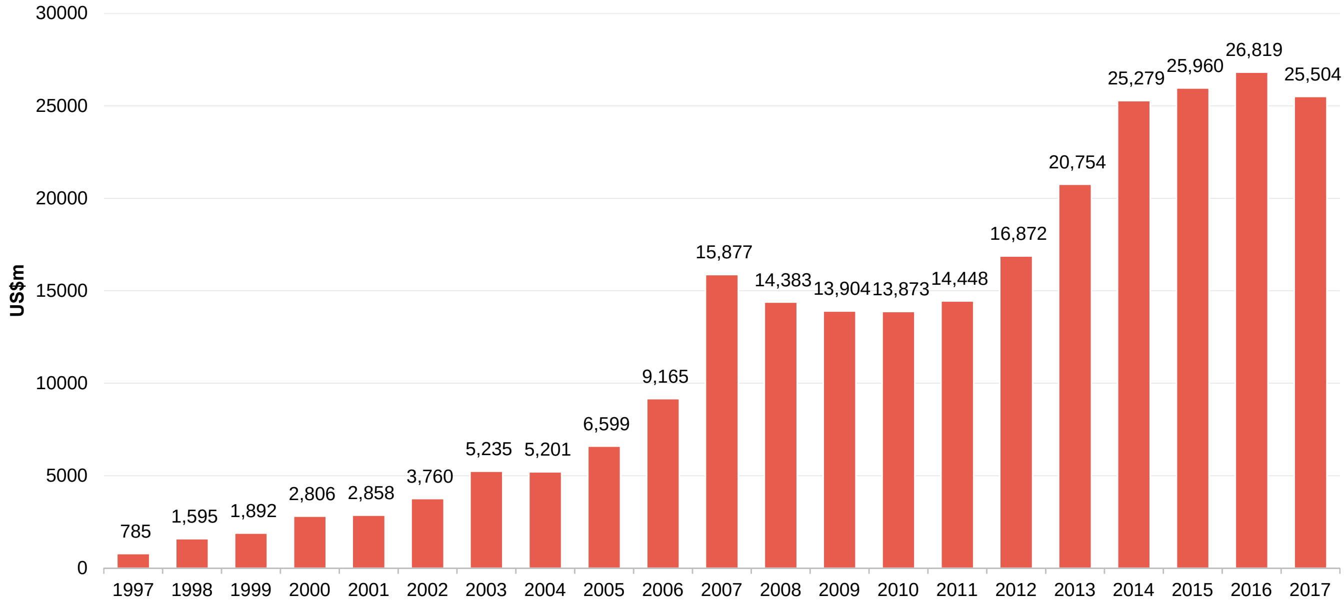
Source: Swiss Re, Artemis

10-year average issuance $5.5bn

The average annual issuance in the last 10 years has been $5.5bn. These instruments are multi-year contracts and there is a market in trading them so the outstanding pool potentially available to investors is shown in the next chart. It can be seen that the gross outstanding at the start of 2017 amounted to $25.5bn.

It is worth mentioning that most catastrophe bonds/ILS cover specific perils in specific geographies so investors buying a single instrument should not expect to get diversity of risk in any meaningful way.

Figure 22: Outstanding Catastrophe/ILS bonds

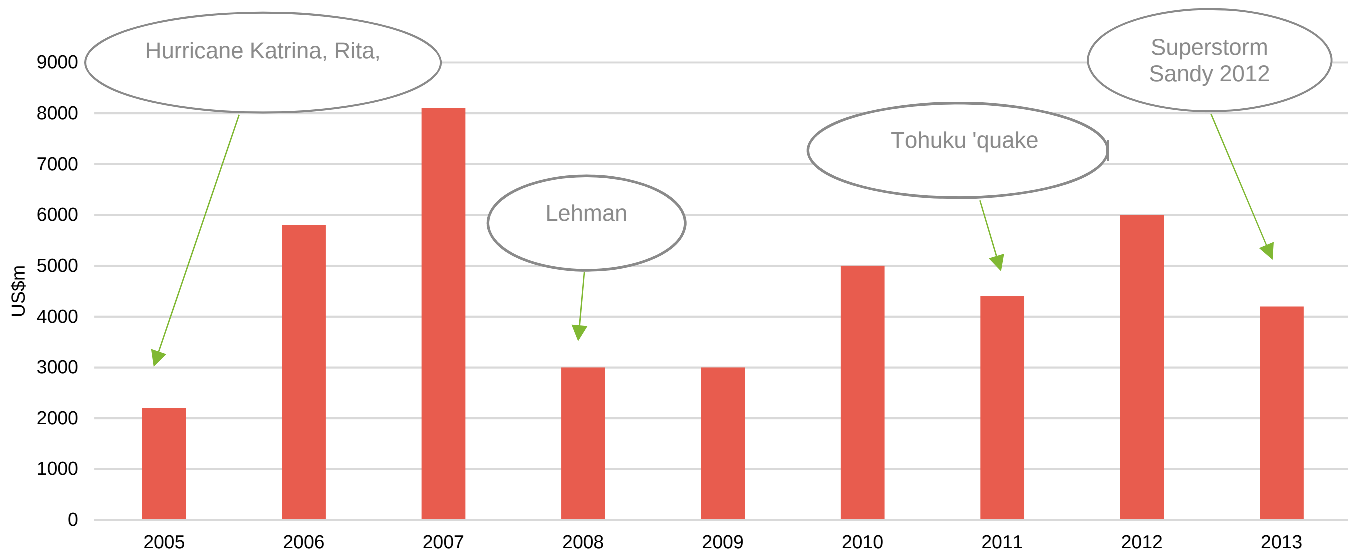


Source: Artemis

ILS issuance continues despite losses

One interesting point to note about catastrophe bond/ILS issuance is that it has continued to occur in spite of large catastrophe events that will have led to claims on some instruments. Thus, despite the spectre of capital loss and losses seen in the market, this form of investment continues to attract investors. These investors also do not seem to have been put off by large non-insurance events such as the collapse of the investment bank Lehman Brothers in 2008 when $3bn of new issuance was seen. The enormous economic cost of the Japanese Tohuku earthquake and tsunami in 2011 (over US$300bn) and the estimated insured cost of US$35bn (Lloyd's estimate) did not deflect the market's appetite as US$4.4bn of new catastrophe/ILS bonds were issued that year followed by US$6bn in 2012. Since 2013, Fitch estimates the US$1.5bn of new issuance has been specifically related to Japanese earthquake cover boosting the capital in committed to that area.

Figure 23: Catastrophe bond/ILS issuance despite large losses



Source: Artemis/Marten & Co data

Who are the reinsurers?

There are a variety of reinsurance businesses; some are "pure" reinsurers while some are also insurance companies. Many are small entities writing modest amounts of premium income. Given the variety of guises that reinsurers can assume, getting reliable numbers is difficult. Looking at historic estimates of the number of reinsurers from industry commentators such as Standard & Poor's it seems reasonable that there are in excess of 200 (it estimated 250 in its Global Reinsurance Highlights in 2004). The same source believed global premium income amounted to $176bn in 2003 of which $146 was non-life.

Figure 24: Reinsurers ranked by 2015 gross non-life premiums

Company	US$ bn
Swiss Re	19.5
Munich Re	19.3
Lloyd's	12.7
Hannover Re	10.2
Berkshire Hathaway	7.0
SCOR	6.2
Everest Re	5.8
Korean Re	4.8
China Re	4.7
Partner Re	4.2
Transatlantic Holdings	3.6
GIC India	2.7
XL Group	2.2
R+V Versicherung	2.1
The Toa Re	2.0
Axis Capital	2.0
Renaissance Re	2.0
MS Amlin	1.9
Arch Capital	1.9
Mapfre Re	1.7
QBE Insurance	1.6
Tokio Marine	1.5
Odyssey Re	1.4
MS&AD Insurance	1.4
Caisse Centrale de Reassurance	1.3

Source: AM Best

Given the relative weakness of rates combined with a trend for larger insurers to retain more risk, 2017 may achieve a similar figure. A list of the twenty-five largest reinsurers according to AM Best ranked by 2015 gross non-life premiums written is shown above. The shorter list shown earlier in this document included life reinsurance premiums as well as non-life

Buyers of reinsurance

Reinsurance is bought by insurance professionals, mainly insurance companies, and most of this is done through insurance brokers. Some large, multinational corporates self-insure and such entities may decide to buy reinsurance cover. An extension of self-insurance is the establishment of a captive insurance company and these will often be buyers of reinsurance cover.

How much is enough?

The amount of reinsurance an insurer buys will depend on a host of variables such as its business model, risk appetite, the price of the reinsurance cover, the availability of cover and so on.

Some broad generalisations can be made about the sort of insurance companies that are most likely to seek significant levels of reinsurance protection.

1. Insurers exposed to significant natural catastrophe risk will typically be keen to buy a lot of reinsurance.
2. Smaller, regional based insurers with limited ability to diversify their portfolios are likely to attempt to use reinsurance to help mitigate this challenge.
3. Insurers underwriting a few large risks and thus have unbalanced, concentrated portfolios of risks, will seek to use reinsurance to dilute this. As an example, an aviation insurer or one insuring large public installations like bridges or power stations will use reinsurance to manage this sort of high value risk concentration.
4. Insurers moving into a new line of business may well seek the help of reinsurance until their portfolio matures.
5. Some insurers will feel obliged to buy reinsurance to protect their credit rating or to satisfy the demands of a regulator.
6. Larger insurers underwriting a great variety of different business lines will generally need to buy less reinsurance protection due to the natural diversification offered by the portfolio.

Reinsurance benefits

The benefits to an insurance company in buying reinsurance can be many and varied. However, in essence, reinsurance should serve to reduce underwriting volatility by taking away the damage that can be done by large risks. In addition, reinsurance is a form of capital and sits on an insurance company's balance sheet as an asset. Finally, a reinsurer, particularly a larger one, can offer an insurer a host of services in the areas of risk modelling, pricing, claims management and so on.

In the case of large natural catastrophe events, reinsurance can protect an insurance company's equity capital enabling it to continue in business. A related benefit of reinsurance cover is that it can be used by an insurer to enable it to underwrite more business than it could manage without reinsurance support. This might also provide an insurer with peripheral benefits such as being able to spread some of its administration costs across a bigger portfolio of business thus lowering the cost per policy sold.

Depending on the type of reinsurance contract, a reinsurer can have a large role in how an insurer prices its business, what the terms of that business are and the wording of the contracts issued to the buyers of the insurance product. The reinsurer is thus a real partner in an insurer's business.

Reinsurers enable insurers to achieve more stable and attractive returns. The reinsurance industry stands behind the insurance industry and can help to facilitate growth. This has wider benefits in society as economies are helped to grow and are also not unduly burdened by the aftermath of natural catastrophe losses when these occur.

Risk management for reinsurers

Insurers buying reinsurance shift some risk off their balance sheet to the reinsurer. However, once that occurs, the insurance company is exposed to a counterparty credit risk. This is the risk that the reinsurer cannot pay a claim when it falls due.

There is thus a credit arbitrage between insurer and reinsurer and typically an insurance company will want its reinsurer to be a higher rated credit or at least at the same standing.

Given these circumstances, reinsurers have developed increasingly sophisticated risk management techniques to ensure they can meet their claims obligations. This process involves an in depth understanding of three pillars, namely, underwriting, capital management and asset management. This will be built upon qualitatively and quantitatively in order to build up a detailed picture of the risks that reinsuring an insurance company exposes it to.

Underwriting

Underwriting is the assessment of a risk or risks, describing these accurately to enable them to be priced correctly. This assessment involves ensuring that the risk or risks to be reinsured are what they appear to be and that the terms and conditions are sensible for the risk being assumed. The reinsurer will also want to ensure that the insurer is not writing more business than it has declared and that this is the sort of business previously agreed.

Assessing the risk

A reinsurer will assess the data the insurer gives it in depth to ensure it really understands the risks it is taking on. If for example it is reinsuring a property portfolio, a reinsurer will do a flood overlay to see how the portfolio of risks might be affected by a severe weather event. If the risks were in an earthquake zone it would carry out a similar exercise. The reinsurer in such circumstances would also determine whether there were some buildings that would cost a lot more to replace than others and represented what is known as a “peak” risk.

Terms and conditions

The reinsurer will establish a modus operandi with the insurer defining what sorts of risks it will reinsure and under what conditions. Having done this the reinsurer should ensure that all the risks it takes on from the insurer conform to the agreed terms and conditions.

Capacity and capital

The reinsurer will ascertain how much capacity it will offer the insurer in terms of size and volumes of risks it will accept. This capacity has to be backed by capital from the reinsurer so it will determine whether this can be sensibly achieved and at what cost.

Aggregation challenges

The reinsurer will examine where in an insurer’s portfolio it might be exposed to an aggregation of risks. As an example, if the insurer has a lot of properties insured near a flood plain or adjacent to an earthquake fault line. These will be modelled carefully and typically, limits would be set for the insurer so that surprise levels of aggregation do not occur.

Pricing

Putting all these things together, the reinsurer will be able to determine a price at which it can offer reinsurance cover that is adequate for the risks borne, the capital deployed, gaining and administering the business and providing a profit. This profit ought to be a proper return on the reinsurer's cost of capital deployed to underwrite the business.

Contract wording

Once the insurer has accepted the price as well as the terms and conditions offered by the reinsurer, the latter will encapsulate all this in a contract wording that both parties will sign and acknowledge. This is the formal part that sees the reinsurer accepting the risk or risks from the insurer.

Asset management

Historically both reinsurers and reinsurers have two streams of income: one from the underwriting and the other from investing the premiums. Cash and highly rated fixed income are traditionally where most premiums are invested so, in recent years, yields on investment portfolios have come down sharply to around 2% or, in some cases, even lower. Nonetheless, asset management remains a core reinsurer (and insurer) skill.

Asset liability management (ALM)

From the foregoing it is clear that a reinsurer needs to coordinate both the asset and liability side of its balance sheet in order to be successful. This is known as asset liability management or ALM. This should be a detailed process picking up on issues such as currency management. Reinsurers often give cover to insurance companies in different currencies. This offers reinsurers another potential risk that needs managing. It can occur for example that following a large natural catastrophe currencies of the affected countries move sharply. Fears of this would suggest a hedging strategy might be required and the cost of this needs to be included in the premiums charged to the insurer.

Capital adequacy

A reinsurer needs to ensure that it has adequate capital for the risks it has taken on as well as a suitable buffer. Things like investment market shocks can (and have) adversely affected a reinsurer's capital. In addition, such events can also make the underlying economics of some of a reinsurer's business worse than envisaged when the risks were accepted. The need for a capital buffer is clear and can make a reinsurer attractive to insurers, but this ultimately needs to be charged for via reinsurance pricing. Historically, this has proved a challenging thing to achieve in a competitive reinsurance market place.

All this may mean that a reinsurer decides to buy some insurance of its own and this is known as retrocession cover. A reinsurer may reinsure some of its portfolio of risks with another reinsurer. Rather in the same way that reinsurance can allow an insurance company to underwrite more, retrocession cover can work the same magic for a reinsurer.

In attempting to find the right balance between retained risks and those retroceded a reinsurer may also seek to go down the securitisation route. In particular, it may deem some peak risks to be ideal to be securitised into some sort of Insurance Linked Security (ILS) or Catastrophe Bond.

Diversification

If a reinsurer manages to get underwriting and investment risks synchronised with the available capital it will also need to be a diverse business to survive in the long term.

In order to be successful, reinsurers need a diverse business and one way this can be achieved is by underwriting risks in different parts of the world. Diversification is a common-sense strategy and one driven essentially by large numbers; statistically a larger portfolio is less volatile. Lower volatility can ultimately convert into lower capital costs.

Types of reinsurance

There are a variety of forms of reinsurance but it may be described simply as splitting into proportional reinsurance and non-proportional reinsurance.

In proportional reinsurance, in all its forms, the reinsurer and insurer divide all the premiums and losses between themselves in an agreed proportion, hence the name.

Non-proportional reinsurance sees the reinsurer agree to pay claims above an agreed amount up to a second agreed level of losses. The reinsurer charges the insurer a premium for the cover that it will calculate and agree with the insurer. This type of reinsurance is often known as excess of loss (XL, XoL). There are also relatively new forms of reinsurance that can take a number of different forms and are truly bespoke in nature. Generically, this sort of cover is known as ART or Alternative Risk Transfer. Mention has been made above of catastrophe bonds, ILWs and variants in this area that have attracted non- insurance professionals into the insurance and reinsurance world. These products would fall under the ART umbrella. ART began in the 1980s with things like finite reinsurance and multi-year and sometimes multi risk products.

Finite reinsurance involves sharing profits and losses in certain pre-determined portfolios and is used to sanitise a portfolio that is good in parts but needs the bad parts separating for the health of the whole.

QuotedData

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