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MARKETS

Investors Who Bet On Storms, Disasters Gauge Trade Winds

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Which way will the winds blow?

With Hurricane Ivan moving from east to west over the past few days, hedge-fund managers such as Greg Hagood in Bermuda are monitoring their hurricane-tracking and property databases to figure out what the right trades will be before Ivan hits the U.S.

Ivan already has thrashed Grenada, Jamaica and the Cayman Islands and is expected to zero in today on western Cuba.

Blamed for at least 60 deaths, the storm is expected to then churn through the Gulf of Mexico before making landfall late Wednesday in the Florida Panhandle. If Ivan comes ashore at northwestern Florida, which is less populated than the state's east and west coasts, insured losses are likely to be lower than those caused by Charley and Frances. The storm with 150 mile-an-hour winds has resulted in an unusual amount of trading decisions for Mr. Hagood and others in the little-known hurricane bond industry. It is the first time since 1964 that three hurricanes -- Charley, Frances and now Ivan -- could hit Florida in an Atlantic hurricane season, which lasts from June until November.




Greg Hagood

"My hunch is there will be a lot of stuff kicking around" today, Mr. Hagood said of the bonds.

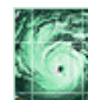
Money managers such as Mr. Hagood buy and sell hurricane bonds -- also known as catastrophe, or "cat," bonds -- that give investors a chance to take on some of the risk of paying claims in the event of catastrophic losses. The bonds pay a relatively high interest rate, but investors can lose both their principal and interest payments if a storm triggers losses at or exceeding an amount set when the bonds are sold. The investors' money is then used to help pay for insurance claims.

Cat bonds first began to appear in the 1990s after insurers and reinsurers suffered financially from storms such as Hurricane Andrew that struck Florida in 1992 and the Northridge Earthquake that hit California in 1994. From 1989 to 1995,

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1 IVAN'S PATH

[Hurricane Rips into Jamaica; Death Toll Rises²](#)

total insured property losses in the U.S. were \$75 billion, 50% more than the property losses from the prior 40 years, according to Standard & Poor's.

Insurers typically purchase reinsurance to lay off some of the risk of the policies they write. But a company looking, for instance, to obtain \$2 billion in reinsurance coverage might be able to secure only \$1.5 billion of that from traditional reinsurance companies. In such a case, the insurer might issue a catastrophe bond for the remaining \$500 million.

Reinsurance giant **Swiss Re**, for example, is a major issuer of catastrophe bonds. A year ago, under its Arbor program, Swiss Re issued six catastrophe bonds with four-year maturities and total protection for Swiss Re of \$205 million.

Because the cat bonds typically are meant to pay only for once-a-century type events, or a roughly 1% chance that the bonds will default in any given year, the bonds pay relatively high yields, according to James Doona, a director in the insurance-capital markets area at Standard & Poor's. Mr. Doona said mutual funds and other institutional investors invest in catastrophe bonds because their performance isn't correlated to stocks or other fixed-income instruments and thus provide a means of diversifying a portfolio.

Other investors such as Mr. Hagood and his hedge fund Nephila Capital Ltd. in Hamilton, Bermuda, specialize in cat bonds. Mr. Hagood said he sometimes sees opportunities when big institutional investors, lacking tools to analyze real-time storms, sell the bonds as a big storm threatens. But Mr. Hagood then might buy the discounted bonds if he believes the storm might not be as bad as others fear. (His fund is named for the Nephila spider that, according to Bermuda folklore, senses when hurricanes are approaching and spins its web lower to the ground.)

The cat-bond sector is growing. According to Moody's Investors Service, the issuance of cat bonds in several years leading up to 2003 was about \$1 billion a year among four-to-six bond issues. Last year, the dollar value rose by 50% to \$1.5 billion distributed through 13 transactions.

The past week also has seen an increased volume in the sales and purchases of another disaster-related product -- "industry-loss warranties," which insurers have long used to spread their risks when reinsurance wasn't enough. Many of the warranties are written to cover a 12-month period, and they can insure losses in specific countries or states and can be designated to cover such events as windstorms and earthquakes.

The warranties also provide insurers a means of finding last-minute coverage, and some were scrambling to do so last week with Ivan headed toward Florida. "The phone's been ringing off the hook for quotes on Ivan," Steve Breen, a senior vice president at insurance broker **Willis Group Holdings** Ltd., said late last week. He added that Willis arranged five deals before Charley and four prior to Frances.

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