

## Balmy in Bermuda

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### A light hurricane season may provide a windfall for hedge funds

HURRICANE FLORENCE had an immaculate sense of timing. When she shot through Bermuda last month she cut power, blew out windows and was blamed for the deaths of two flamingos at the local zoo (killed by falling branches). Just as she was bearing down, though, most of the people who make Bermuda a global hub for insuring against natural catastrophes were at an industry conference in sunny Monte Carlo.

In contrast to the deadly (and costly) hurricanes of 2005, Florence was a wisp of a storm. That has been the pattern all season. Despite warnings from weather forecasters early this year that more ferocious storms were likely, the hurricane season—which will end in a few weeks—has so far been docile. This is good news not just for homeowners and businesses spared devastation; investors who have poured money into a growing market for catastrophe risk are set to make a fortune. Increasingly, these include hedge funds.

Part of the expected windfall in 2006 stems from the wrathful weather last year. Hurricanes account for the vast majority of insurance catastrophes; the insured loss from Katrina last year (\$45 billion) was more than twice that from the terrorist attacks of September 11th 2001 (\$21 billion). The losses suffered by insurers last year caused a big rethink of the catastrophe market, and many reduced coverage.

Normally, new sources of capital tend to flock in after disaster strikes, replacing some of what is paid out or withdrawn by hard-hit insurers who scale back on the business. Barney Schauble, of Nephila Capital, a Bermuda hedge fund, estimates that insurers pulled out more than \$100 billion of capital last year, while \$20 billion to \$30 billion of new money flowed in. "Net, there was quite a large hole," he says. With tougher capital requirements on catastrophe reinsurers from rating agencies, that led to big premium increases in America when contracts were renewed in January and July (they were flatter in Europe and Asia). Hedge funds sniffed an opportunity and moved in. "There was a shortage of capital and they supplied the capital," says Donald Thorpe, of Fitch, a ratings agency. "They're quite opportunistic and it looks like they will do pretty well this year."

Some hedge funds, such as Nephila, have started their own reinsurers. But returns so far this year appear promising in a wide array of catastrophe-related investments. Data from Merrill Lynch, for instance, show that insurance-company bonds in both America and Europe—particularly those tied to catastrophe risk, such as Swiss Re's and AIG's—have performed better than other investment-grade securities in recent months.

There is also a growing market in catastrophe bonds, which offer investors a chance to bear some of the cost of paying insurance claims if disaster strikes. The bonds, which carry highish yields, are increasingly favoured by mutual funds and other investors.

Despite the insurance industry's focus on weather and climate change, a recent survey by the Economist Intelligence Unit, a sister company of *The Economist*, shows that company executives are more concerned about terrorism than about weather-related risks. That, sadly, is as hard to predict as hurricanes.