Barclays Insurance Forum

Company Participants

- Ed Noonan, Chairman & CEO
- Kevin O'Donnell, President & CEO
- Sarah DeWitt, Analyst
- Unidentified Speaker, Analyst

Other Participants

- Unidentified Participant, Analyst

Presentation

Unidentified Speaker

(audio in progress) with our future of reinsurance panel. The reinsurers have delivered strong results in 2013 where pricing is being impacted in part by the entrants of new alternative capacity in capital. So it's something we are -- it's certainly important to explore.

So here to help us address the future of the reinsurance industry, we have two very important CEOs with us, Kevin O'Donnell, from RenaissanceRe and Ed Noonan from Validus. So with that, let me turn it over to Sarah and she will lead the discussion.

Sarah DeWitt {BIO 18946247 <GO>}

Great. Thank you. We have first from RenaissanceRe is Kevin O'Donnell. Kevin was named CEO of Ren in 2013 and he was previously Global Chief Underwriting Officer. And he has been with the Company in a variety of roles since 1996.

And then on my right here immediately is the CEO of Validus, Ed Noonan. Ed has been Chairman and CEO of Validus since its formation in 2005 and has 34 years' experience in the insurance and reinsurance industry. So thank you both for joining us.

Ed Noonan {BIO 1560381 <GO>}

Clarification, one year and 34 times.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. To start off, there has been a tremendous flood of capital into the reinsurance industry. So what does that mean for the future of reinsurance? Maybe Ed if you want to start that will be great.

Ed Noonan {BIO 1560381 <GO>}

We have various forms of capital coming into the industry. The one that I think gets the most attention has been the pension plan money coming into the catastrophe business, hedge fund money coming into the catastrophe business.

But you also have hedge fund money coming into the broader reinsurance business in search of float to create ongoing permanent capital vehicles for hedge funds and each has different effects. I think the ILS money that has come into the catastrophe business has largely been complementary in that it has tended to play at the higher levels of risk, more remote risk which are pretty capital intensive for people who are underwriting their own [ph] balance sheet. So from our vantage point that's been a very comfortable phenomena although it may not always be but to date it has been.

You see some of the hedge funds investing in sidecars to write retrocession and lower layer risk in territories like Florida which are premium intensive and more volatile. And again that's been largely complementary and both we and Ren have, I think, done well in managing money in those phases and getting payable for it.

I think the real issue is how long does that go on, how much money comes in. Obviously the global pension funds dwarf our industry many times over and so it's really, I guess, kind of the forward issue that is more critical.

Sarah DeWitt {BIO 18946247 <GO>}

And do you have a view on that?

Ed Noonan {BIO 1560381 <GO>}

Yes, look I am getting old. Kevin is a young guys. He will figure it out. No, I think the ILS money has kind of captured the low-hanging fruit, that high layer of risk there is -- the notion that there is a lower cost of capital and to some extent that's true, pension funds in particular may have a lower hurdle rate for return of capital because of the non-correlating asset and they just want exposure to the sector.

And so if they are willing to accept a 6% or 7% return on that money that's better than we can do use our own balance sheet. That doesn't actually translate very well though as you get lower and closer to the loss. And so I think, as I said, it kind of gotten a low-hanging fruit and to continue to move down risk they'll have to overcome some structural hurdles and return hurdles to accomplish that.

And I think the second perceived cost of capital advantage is that they have a lower cost of capital for peaks of risk. And so you see ILS money playing for the most part in Florida and more broadly for US wind. It's broader than that. But the vast majority I think is in those two areas. And again, if you are underwriting against your own balance sheet, those are your peak exposures and so your highest cost of capital risk. And so again that near-term advantage is pretty comfortable for us as a reinsurer. We're happy to manage that money on your behalf and not have to use our capital in those spaces.

But from here where it goes, I think to move further down the chain of risk is going to be -- there are some real structural challenges, not least of which is that the customers aren't yet at this point anywhere near as comfortable using indexed products or cap-ons [ph] or even traditional reinsurance from ILS players in the same way that they do the traditional reinsurance product with long-term continuity reinsurers.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Great. Kevin?

Kevin O'Donnell

I think we think about the world in a similar way as to what Ed described and I think there is -- you talked [ph] about capital, I think it's important to think about the risk side as well. So if you look at the capital, it's kind of interesting where were used to capital coming in and it comes in. And historically in very intense periods coming after events when rates are going up. And what we are seeing now is capital looking to come in when rates are going down. I think that's kind of a unique thing for this cycle.

The other thing we are seeing is the amount of risk that's coming to the market outside of some small increases in Atlantic hurricane really it isn't expanding. So you've got reasonably flat supply, increasing demand and falling prices. I think then you break down the type of capital that's coming in and I think Ed touched on the two most prominent types. One is that that's interested in property cat or the type of capital that we've managed for a long time and then the new hedge fund capital coming in looking for very different type of returns.

The capital that is coming in on the reinsurance side, I think, is capital that there is a lot of talk about the efficiency that that capital brings. And Ed touched on it being very capital -- it can be capital efficient for a peak zone which we agree with. And I think there is an extension that it's always cheaper capital and that's just not true. And if you take different vehicles that we've put together and Ed has put together there, those vehicles are, like if you take Top Layer Re for instance, that is the most efficient vehicle to write high layer international risk.

So for a pension fund to come in and say that they are more efficient capital, they are actually just competing on stand-alone price. They are writing a risk cheaper than we are willing to accept that on a stand-alone basis. And with that, I think there is going to be -- although this capital is going to be permanent, I believe we wouldn't have built what we've built here and you wouldn't have built what you've built, I think there will be cycles. So the fact that risk is being priced at level that we think is challenging for us to commit to, it's not an efficiency issue, it's a stand-alone issue. I think that will create some degree of cycles although the capital will be here.

The other piece of capitals that's coming in is the hedge fund capital. And what we have been paid for is to write risk that brings an underwriting return. And with the hedge fund capital that's coming in it's largely being paid to write risk to facilitate a highly liquid -- or theoretically highly liquid tax advantage way to participate in hedge fund returns. So I think if you think about it, these things are coming in for different reasons. One of them, they are paying us to underwrite, the other one they're saying, I need underwriting risk or a reinsurance risk in order to facilitate the capital stream that my investors want.

I think there is value that underwriters can add in each of them. But it's a very different approach to the value that one can bring to servicing that type of capital. In the end, all of the efficiency that this capital brings in is something that will ultimately need to be transferred to the buyer. So the excess returns that you can have from the first-move advantage or from having the most efficient capital, this is a transparent, this is an efficient market. Those efficiencies will ultimately move to the buyer. And I think those that are best situated to add value as the kind of the conduit between desirable risk and efficient [ph] capital are going to be the winners but not everybody is going to be able to do that to make that transformation as efficiently as they need to.

Sarah DeWitt {BIO 18946247 <GO>}

You touched on this a bit maybe you could just elaborate what are the competitive advantages or disadvantages of traditional reinsurance versus the alternative reinsurance? You mentioned non-peak zones, traditional is just as competitive or more competitive as well as lower layers. But is there anything else you would add to that list?

Ed Noonan {BIO 1560381 <GO>}

I mean the structural issues of the products. First the traditional reinsurance product has been around for 100 years. I mean it has been litigated, tried, tested in the courts and there is a rich body of legal precedence that you can generally rely on.

Inability to pay is relatively infrequent, willingness to pay relatively infrequent and so it matches up perfectly with the customers' needs. It covers their own underlying ultimate net loss it doesn't introduce basis risk, it introduces counterparty risk. But no basis risk. And so it's actually a very efficient product.

The ILS product has other positive attributes. But in most areas it does introduce basis risk. It doesn't have long tried and true kind of legal interpretations that you can rely on. We don't know yet about willingness to pay. Ability to pay isn't really a question because most of these are collateralized in the end. But willingness to pay will take time to sort out. And I don't mean to imply that there is an issue, just hasn't been tested yet.

The traditional reinsurance product is an evergreen product. A claim occurs today and five or six years from now it develops adversely, you go back to your reinsurance, say, gee, sorry. But my earthquake from San Francisco in 2014 just developed and that traditional reinsurance that don't pay loan owe you [ph] the money. In the typical ILS you release the collateral at some point, three or four years out so you don't have that evergreen nature of it that you can go back and rely on to the same extent.

It doesn't have necessarily the same continuity value in that if you have a mega event in September or October all that capital is going to be tied up for the following year. So if you buy reinsurance through that product mechanism, can you count on being able to renew coverage the following year, they're going to have to literally double their capital of risk. And can pension funds go back to the investment committee and make that decision very quickly in the span of a few weeks, they will be able to meet the market needs, some will and true. And maybe all will. But I think there is an unproven element to that. And so the traditional reinsurance mechanism works extremely well for customers and I think the ILS, there is no reason it shouldn't ultimately work extremely well because with any new product or structure, there is a sorting out period that we'll have to go through before you can get to that point where you say yes, this is just a good ready substitute for the reinsurance product.

Sarah DeWitt {BIO 18946247 <GO>}

Okay, Kevin (multiple speakers).

Kevin O'Donnell

I think those are all great points I think the --

Ed Noonan {BIO 1560381 <GO>}

And Kevin by definition I made them, they are great points.

Kevin O'Donnell

Yes, they are and that's exactly the point of love. So I think from a capital, I think the peak zone I think is one. Another one I will touch on a little bit, I think another area that a non-rated balance sheet or a third-party capital can be effective is where you build leverage into the product. So worldwide retro or something like that where you're taking lots of different territories that can be exposed being paid for each of those territories but only providing a single limit. So I think that's -- there's an efficiency there because it uses a lot of capital on a rated balance sheet.

The reason it uses a lot of capital on a rated balance sheet is because we do that by writing a lot of different types of cover. And by having an excellent ERM and different ways to think about our exposure we can expose our capital more than once. So I think we do have a natural benefit in being able to do that against ILS capital. I think ILS is effective in certain situations. That's why we both brought it to the market. I think the way in which it's sold, there are some structural issues that are difficult to overcome. Ed touched on a lot of them with regard to the rated balance sheet, the evergreen nature of it, the fact that we all deal in an utmost good faith environment. We understand what people are buying and the risk that they are ceding to us and how we are underwriting it.

Ed touched on another important point which is ability to pay and willingness to pay. Having collateral provides and gives you assurance of the ability to pay. I think it is a different thing to have -- to take the money and it is a different discussion to say that, yes, it is yours to take and that's what the agreement say. And I think there is a long history in reinsurance as how to solve those sorts of issues. There is lots of track record of how to solve those issues which are sure to emerge in the ILS world.

Overall, I think there is room for both types of capital in this business and it's simply -- it's funny, in one of these panels if we were to go back five years ago, it would have been underwriting discipline and how do you underwrite. And now all we do is talk about the cost of capital and that's really why it's here. If it's more efficient capital, we have an obligation to deliver to our customers and our role is to just to make sure we provide a valuable service in the delivery of that risk and delivery of that capital. So I think it will be here to say. But I don't think either one is going to be the 100% winner of the future. I think it's going to be a blended platform that's the winner.

Ed Noonan {BIO 1560381 <GO>}

Let me put on plug for the Renaissance and also Validus remodel on this and -- but (inaudible) more than anybody. When you're representing third-party investors, if you're a reinsurer you come for that same context of utmost good faith and you say, look I am not going to -- I don't want to deal with third party investors that don't understand the risk they are taking up and I don't want to sell them a product that's based on just kind of me having bought a single license to a commercial model running the most basic version of it and saying that's all good.

And the reason I bring that up is that when you think about what will have to be ultimately the source of arbitrations, litigations however you want to think about it is, there will be events that happen where investors say, I didn't expect that, I never saw that and then they will say, hey, that was a non-modeled peril. You told me you model everything. But that's not even in the commercial model, how can that possibly be. So there is a little bit of an element there you get what you pay for. If you pay 65 basis points for somebody to manage your money they are not going to have the type of in-depth analytics and research that a Renaissance or a Validus has. On some level their job is simply to put the money to work as quickly as they can take it in. And so from an investor's standpoint there will be some sad stories and all the associated legal actions that will go with that and that makes me uncomfortable.

It will discredit the products in some quarters when it comes to the fore and in some ways slow down what should be a very positive kind of structural change in the capital of the industry and how the industry uses capital but we see it every day and that's not a good thing. And that isn't to say that all ILS managers are alike in that regard. There are some that are very professional and very knowledgeable but not all and that gives me a little bit of a concern.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Given that there's still a lot of third-party capital on the sidelines, do you expect prices to build spike after a big event if this capital comes into the market?

Kevin O'Donnell

So we approach the world there is a big price risk based on the amount of volatility and on the amount of capital that's using. I think in the market if you look at more generally there has been a tendency for the prices to rise pretty materially after an event. The discussion that this -- the third-party capital has brought to bear is really whether there will be cycles or that's sort of punctuated equilibrium will occur again.

And I think the -- my belief is there will always be cycles. There will be times where different types of risks are more in favor or less in favor but the amplitude of the cycle may be less. If you go back at 1.1 [ph] we saw pretty material softening at 1.1. So that would challenge that that well on the down side we've seen that there's still cycle.

So the evidence we had is that there is a cycle on the downside, I believe there will be a cycle on the upside, it will be interesting to see whether the amplitude is truly less. Part of it will depend, as it always does, to the type of event, how large the event is, how surprising it is, what else is going on in the world.

Ed Noonan {BIO 1560381 <GO>}

I think what will change is and it already has in so much times, you only get one shot at an (inaudible) event today. Something happens, it's not like the market is going to correct and then correct again the following year, it's one shot. And so I think Kevin is right the amplitude is a bit on the novel. But probably there is a downward bias there. But certainly the duration of market corrections is now instantaneous and over which is a very different circumstance.

Unidentified Speaker

What does that mean, Ed?

Ed Noonan {BIO 1560381 <GO>}

We have a big loss, Sandy happens. You got to charge for it at January 1 for all those renewals and July 1 for those renewals and that's it.

Unidentified Speaker

Yes.

Ed Noonan {BIO 1560381 <GO>}

The following January 1 there's no more market movement based around Sandy. So you get one shot at its pricing correction or pricing adjustment however you think about it, that's it.

Unidentified Speaker

And Ed do we see the same with more concentrated markets like the big international losses in 2011, 2012, Tohoku, New Zealand earthquakes, Chile, as pretty much a one renewal opportunity?

Ed Noonan {BIO 1560381 <GO>}

(inaudible) lucky to get one renewal opportunity at it, Yes, no the Japanese market corrected, rates basically doubled and stayed there. That's it. There was no ongoing correction from that.

Kevin O'Donnell

I think if you think it was regional and it was short terms from an underwriter's perspective, you need to act more quickly and probably with less information. I would argue that we were probably headed there anyway. I think whether this new capital came in or not, I think people had greater confidence in understanding the loss, people had greater confidence not only what was being ceded to them but to how much risk they took. With that I think there was more certainty to put out limits close to that. So with or without third-party capital, this was a trend I think we were going to see.

Sarah DeWitt {BIO 18946247 <GO>}

Looking at your own third-party vehicles, how do you think about the economics of managing that business for a fee or taking the underwriting risk yourself? Maybe Kevin, if you want to start?

Kevin O'Donnell

Sure. Obviously it's fee income versus risk income. And the first thing we do is when we are thinking about bringing in capital, we look to the customer and see if there is a market need. Once we recognize there is a market need, then we figure out whether it's our capital or somebody else's capital. I think it's one in which there's no right answer as to exactly how to calibrate it. But it's one that having more capital under management is not a victory to us.

I think what we look at -- one of these I have said before, we can double the size and eventually find investors who will take half the return and keep our fees the same and everyone, say, go that's been a huge success. They managed more money but nobody in the economic systems made more money. So I think we look at it as kind of delivering value to the customers and delivering value to the investors. The other thing I think one needs to be careful about is to determine whether this is incrementally new business to you or it this cannibalistic to your existing book and you can set your fees based on that. If it's incrementally new business that you may not otherwise be able to write, you can accept a lower fee and if it's, at least the way we would analyze, the benefits cannibalistic or business we already have but we're going to share it with a third party.

So I think there is multiple ways to kind of come in and think about the right pricing of it. But it's not one simple solution or one simple formula for all sorts of capital, all sorts of situations.

Ed Noonan {BIO 1560381 <GO>}

Not terribly dissimilar. We are not terribly interested in cannibalizing our existing business. And so when we look at high layer third-party capital, we look at that as being additive in two ways. First, it's nice to get fee income but more importantly, it makes us more valuable to the customer. So Validus Re puts that down that line and then AlphaCat puts down another big slug of capacity (inaudible) customer which has got more and better value from us and that makes us more important when they think about the reinsurance next year and New York law et cetera.

And so, for us, we tend to start with the market positioning strategy more than the fee income strategy. On sidecars on that a bit different, yes in some ways it makes us more valuable to the brokers because we can help them solve problems. But that's more of a straight in. We like doing 20 economics like everybody else and when there is opportunities to put sidecars together, that's a good way for us to monetize our (inaudible) generating business and underwriting it and analyzing it and bringing to investors. So just kind of two completely different segments, where we think the one very much strategic in building our core business and the other one pretty opportunistic.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. And then looking at your own vehicles of law, what are you seeing more near term in terms of demand for these investments and opportunities for you to deploy that capital?

Ed Noonan {BIO 1560381 <GO>}

There is still some demand out there for retro session based sidecar products and -- so you can put more capital to work in that space. We feel a little bit critical [ph] about that because we think the retrocession market is getting pretty aggressive. But again we're only interested in dealing with investors that understand fully the market dynamics they working into.

And so there are still some opportunity there. There may or may not be a high layer opportunity like Kevin, we're not -- or we don't measure success in terms of assets under management. And so simply taking in more assets isn't success for us unless we know in advance how we're going to put it to work before customers, what type of returns et cetera. So there may be some opportunity. It's not a huge opportunity today. Right now the market is kind of at least for the -- for a very short moment at some sort of equilibrium.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Kevin.

Kevin O'Donnell

Yes I think extending, Ed's point on the retro, one of the things we do, we increased the size of our retro sidecar last year. We got rid of our Florida sidecar, changed some investment -- some of the investors in DaVinci. But all in all, we didn't really, absent the retro, we didn't bring new capital really to the market and I think that's likely to be what we see this year.

I don't see us putting together unless something materially changes between now and June 1 of Florida sidecar and with that I think we're going to be end up being pretty comfortable with the platforms that we have.

If you look at the way we are structured there's already a lot of flexibility as to where we can move risk in and move risk out. But it's not one that I would say we need to add a there's one hole or something where we need to add a particular type of vehicle to meet some demand in the market.

Sarah DeWitt {BIO 18946247 <GO>}

If you look out longer term how large do you see the third-party management business becoming as a % of your overall business? Kevin, maybe you want to start?

Kevin O'Donnell

So again that's one that -- there's kind of -- I guess there's two ways to think about that. One is, are we growing as an organization or are we changing the mix between risk and fee. And I think if we're growing I would expect that we'll continue to grow our risk and our fee whether that becomes materially different than what it is is really going to be where the opportunities and what type of capital to service. I think from -- we're constantly looking at the right balance that we have between how much risk capital we have exposed and how much fee capital we have exposed.

And right now we're comfortable with that mix. Going into a big renewal at June 1 we'll reassess it throughout that renewal and reassess it post the renewal. But right now I would say that where we are is some place that we're very comfortable. The best case scenario is that we can grow the pie and there is more risk for everybody. But right now, that's not the environment we're operating in.

Ed Noonan {BIO 1560381 <GO>}

So it's hard to actually plan forward on that issue just because it's a bunch of moving pieces. If in fact -- there is tens of trillions of dollars of pension assets and they want into our business which is kind of a $400 billion industry in terms of what we provide and they're wanting badly enough then that they will come when we will simply not be able to underwrite against the balance sheet because we generate good returns, we'll give back all the capital and be an asset value. I don't think that day is on the horizon but you can't rule it out. I mean when structural change happens I think just be prepared for anything. But like Kevin, it's kind of what you do in the meantime. And I think we feel very good about where we've got ourselves positioned. If suddenly assets under management in and of itself was a legitimate strategy, okay then we go out and raise assets and start putting them to work.

In the near term I think we're more comfortable saying, hey, here's how it fits strategically and makes us more important in the marketplace and to our customers and here's the opportunistic piece where we think we get paid really well for what we do and helps us monetize our skill sets. And at any point in time that mix will shift based on what's happening in reinsurance market and the global interest rate environment and so it's little bit difficult to look at even 18 months and know what that will look like.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Great. Maybe we switch gears now to more of your core business. What ROE are writing new business at and where do you see that headed? Maybe Ed you could start.

Ed Noonan {BIO 1560381 <GO>}

Yes, we don't give guidance since if I give you ROE I would be -- somebody would quickly back into -- term that it's the guidance. What I would say is that we think of our business as needing to return something on the magnitude of about 1,000 basis points over the risk free rate and our risk free rate is kind of two years.

And we're currently underwriting business above that target, not as far above as we were last year. But we're still underwriting business in the reinsurance segment at or above that and moving [ph] segment at or above that and the aggregate clearly above it.

Sarah DeWitt {BIO 18946247 <GO>}

Kevin, anything to add?

Kevin O'Donnell

Yes, I think -- when we think about the world, we divided it into acceptable return, lower return and negative return. The negative return nobody is making money, low return you can argue that there is different types of capital that these are measures that might be able to make some money and then there's acceptable return. We still have an ample access to acceptable return business for us to continue to build attractive portfolios. So I feel, with where we are today, the risk that we're taking is risk that we're well compensated for. We measure that in really two ways. We measure it on a stand-alone basis. Is the risk and the volatility embedded within the session to us or within the risk being sold to us adequate and then how much capital does it support therefore measuring how much -- what's the marginal return to us.

By doing both I think we avoid some of the mistakes that can be made from over-emphasizing the benefit of diversification. But it's one that not -- we've seen some cracking in the armors to how we think some other people are looking at it, not only within the rated balance sheet environment but within the third party capital environment as well. So I think for the foreseeable future I feel very comfortable that we can continue to build attractive portfolios.

Ed Noonan {BIO 1560381 <GO>}

Is there a quantitative hurdle for that Kevin?

Kevin O'Donnell

For our measures between --

Ed Noonan {BIO 1560381 <GO>}

Yes.

Kevin O'Donnell

So what we do is -- in order to do that what we do is we take -- we capture all the risk that we see, we bring it, we rate it and then we divided it out as to how -- what sort of returns, not the risk that we're writing but what returns is afforded to the overall market and then we can figure out at what segments and what percentage of each segment that we have. But it is a very quantitative process that we run.

Sarah DeWitt {BIO 18946247 <GO>}

What do you view is the run rate premium leverage for your business and how low do you think this could fall?

Ed Noonan {BIO 1560381 <GO>}

Our businesses has a couple of different components to it. We've got a syndicate in London that can write up 2 to 1. We've got a reinsurance operation in Bermuda that probably can't write much more than half to one. And so, we could comfortably take on significant amount of more business against our current capital base through the syndicate. But we tend to right size our capital, run the reinsurance opportunity at any point in time and while we always leave a reasonable cushion around that if we were to seek to grow the reinsurance operation by 50% we have to commit more capital to that.

And so I still don't know that you get much more above 0.6 to 1 in the reinsurance business and a lot of that has to do with mix and where you are catching in that. So that's a pretty crude way of describing it. But for us in the aggregate, as I say, we could comfortably probably take our overall business up to something in the 0.8 to 1 particularly if most of the growth is coming from the syndicate as opposed to the reinsurance operations.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Kevin.

Kevin O'Donnell

I think it's smart to have a lots of different ways to think about how much risk you're taking, how to measure risk and that's not one we spent a ton of time with. We think about -- much more about what's the portfolio of distribution that we have and how much of capital is required to support it. And so, questions like what's the probability of losing 1% of your capital 10% of your capital, 15% of your capital that will help drive much more about how much capital you need. Premium is much harder to think about premium in the context of understanding the amount of capital required, particularly for the types of lines that we have. I think within Lloyd's it is a more prescribed environment. Premium will dictate a little bit more of your leverage. But in general it's I think thinking about against the stochastic distributions is a more robust way to think about the capital you need to have in your business.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Maybe you could talk a little bit what's your view on consolidation in Bermuda and Ed as an active acquirer in the past maybe you could start off?

Ed Noonan {BIO 1560381 <GO>}

Somebody asked this question this morning and it kind of feels like, Ed, you have been a serial killer we haven't seen any bodies lately, what are you up to. No, for us there is diminishing returns certainly in that catastrophe space, there is no need to -- acquiring another catastrophe company doesn't really do much for us unless it was an attractive financial transaction.

And when you get beyond that I wouldn't say that there is no company in Bermuda that we wouldn't find attractive. But I don't particularly feel compelled by other Bermuda reinsurers at this point in time. I think we would prefer to continue to grow the direct insurance part of our operation. We're about 50-50 today.

And I think longer term, we have a bias towards growing the direct insurance operations and that isn't really the Bermuda market. So I think there should be more consolidation in Bermuda. You can see lots of natural fits I suspect will be less the catalyst around that than we have seen [ph] in the past.

Sarah DeWitt {BIO 18946247 <GO>}

That's through Lloyd's you would want to grow it or through a different vehicle?

Ed Noonan {BIO 1560381 <GO>}

Lloyd's is a different vehicle. We can continue to grow through Lloyd's very nicely almost anywhere in the world. But whatever the right vehicle is to capture market opportunity is what we will do [ph].

Sarah DeWitt {BIO 18946247 <GO>}

Kevin, any thoughts?

Kevin O'Donnell

I think a lot of what we talked about today is just increased efficiency in the business. And I think whenever there's increased efficiency, there's going to be some change. There will be winners and losers. And I think those that are adding the least in contributing to the rising rate of efficiency are likely to be those that are less needed by customers and by capital. So I think we probably will see some consolidation. But it's -- I think I would have said the same thing if I was sitting here last year.

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Great.

Unidentified Speaker

So you are not sure on the catalyst of consolidation?

Kevin O'Donnell

I think valuations, if you look at it, they were more compelling last year and we didn't say than they are this year. So I am not sure what sort of catalyst we'll see in order to have it happen. But you would think whenever there is changing efficiency in a market I believe our market is becoming more efficient. You'd expect to see some of the -- those who are performing at a less high level to be taken out.

Unidentified Speaker

And you measure that on based some of the capital efficiency (inaudible).

Kevin O'Donnell

I would say returns, yes.

Sarah DeWitt {BIO 18946247 <GO>}

I can't have reinsurance panel without a discussion about the mid-year renewals. So maybe if you could just give your thoughts on what your expectations are for the mid-year reinsurance renewals that'd be great?

Ed Noonan {BIO 1560381 <GO>}

The interests have never been willing to talk to market down, I will assure you. There will be a mid-year renewals that far I'm willing to go that far. There is pricing pressure in the marketplace for all the reasons we've been talking about. And so that will probably continue to be reflected in June in Florida in July 1. Florida is, if you're in the ILS business, it's kind of ground zero. You have to put a lot of money to work in Florida. That's the most premium intensive part of the market.

And so that adds to the competitive dynamics in Florida. I would say last year the competition in Florida was as much or more driven by reinsurers and by ILS funds and the competition, one I think was largely driven by reinsurers and not very much ILS funds. And I think that's what we're likely to see at 7/1 [ph] the competition will be a function of reinsurers doing a much greater extent than ILS funds. But not -- I don't see the market falling off the cliff but no kind of willing to try and get specific and give the customer something to chew for [ph].

Sarah DeWitt {BIO 18946247 <GO>}

Okay. Kevin?

Kevin O'Donnell

Ed was perfectly vague as I would have been. So have really nothing to add.

The one thing I would add [ph] there is some demand coming out of Florida so I think there will be a little bit uptick in demand which is something we didn't see at 1.1. All that said I don't think that's going to necessarily change the direction of the tide.

Unidentified Speaker

Where's that direction coming from?

Kevin O'Donnell

That's just with all of these talking about there is more capital than demand. So people want to deploy capital into risk.

Unidentified Speaker

(inaudible) is that demand is going up?

Kevin O'Donnell

Well, demand will go up. I think we've seen -- there's been a couple of good things that have happened. There's the EPIC they [ph] have had a discussion about potentially buying more citizens as they have instituted the clearing house where some risks have moved away from citizens. They've also started another round of de-pops, a lot of the primary companies have had some growth. So whenever there is a risk that moves to the private market there is more reinsurance dollars associated with each dollar of original premium. So I think there'll be naturally some expansion there. But it's not -- again, it won't be enough to change the tide of all the things we talked about with rate pressure.

Sarah DeWitt {BIO 18946247 <GO>}

As on large catastrophe loss, how much further do you think reinsurance prices could fall before they hit a floor and you start walking away from business?

Kevin O'Donnell

I think every risk has a price. So I think going back to what we said before we look at a stand-alone return when we look at a marginal return. So to think that that one price we walk away from everything it really matters to the construction of your book, it matters to the volatility embedded in the deal.

So I think there is scope. I think it has gotten tighter. If you take even just to move outside of cat and let's look at some of the specialty lines, we've written more quota share we saw that the underlying fundamentals to some of these specialty quota share business we've written were actually kind of like with what we see in those ceding commissions going up.

So I think there's places where the price that you're seeing on the primary the price you are seeing in reinsurance. But it's not going to be a binary point. What will happen ultimately the fundamentals of those businesses begin to slide back, ceding commissions will probably come down, you probably have more runway in that than you do in some other lines. But it's not going to be a single point down 10% everybody is out, I don't think it will work that way.

Ed Noonan {BIO 1560381 <GO>}

Picking up on Kevin's point, I think we kind of broadly see the world in the same terms on this. We have lots of risk today that we're pricing it at 40% and 45% return on equity. That's a function of how it plays against our book or some different insight we have about the risk or perceived to be have about the risk most often how it plays against our book. And so, in assembling a portfolio, you have to know that as competition grows this pool of attractive business shrinks and so you're not immune to it.

And therefore in the overall portfolio construct may have to shrink. But that isn't to say that there is a moment in time, let's say, this far and no further because everything operates on a continuum. And I think what happens with more business kind of becomes marginal and you end up kind of pulling back and cutting back your lines is frankly there are customers that you worked hard to build a position with that you're not going to leave over a short-term pricing. And so, now you reduce your lines as much you can. But you're not going to walk away from the customer.

And so you're willingly accepting a lower return in that circumstance. But I think the big thing that helps the industry is that all the money that's flowed in has also flowed into the retrocession market. And our job is to continually try and move the portfolio towards the efficient frontier. And we do that deal by deal. But in your retrocession purchasing you get the chance to do that in a big step all at once. And what we've seen this year with most of the nature and breadth of coverage available in the pricing of it we have to move out considerably all at once towards the efficient frontier and that offsets an awful lot of deterioration and other aspects of the book.

So yes maybe price came down. But the impact to the book isn't nearly as direct as we've seen because we also were able to structure much more efficient and economical retrocession program. And so, there's a number of moving dynamics that all fit into how well you can construct the book. But at the end of the day, every reinsurer has spends before the rating agencies such as there how much risk I have, the rating agency say here's how much capital you need to put and that kind of becomes the ultimate governor on this.

So that's actually a constructive thing for the industry to the extent that it means that you can't have rates just kind of go into free fall and fall to the floor. We're not. I don't suspect that anybody is scraping along near their rating agency minimum. But I suspect there is closer to it than they were, a year ago or two years ago. And so that kind of moves us closer to the point where in aggregate terms across the industry, hey, pricing probably is going to have to reach the bottom.

Sarah DeWitt {BIO 18946247 <GO>}

Okay, that's great. Why don't we stop here and open it up to the audience if there's any questions?

Unidentified Speaker

As we're doing that, I think Sarah mentioned another part to that question, how significant of a loss do you think it would take to need to turn the property cat market? Warren Buffett in his annual letter talked about the potential for a $250 billion insured loss. And he said as he will be ready to write the business the next day. And as a point of reference I mean that's five times Hurricane Katrina it's almost half US industry capital. How big of a loss -- industry loss do you think it would take to turning the market?

Kevin O'Donnell

I think there's couple of things to that. One is it surprising. So the example I would give is I think like a New Madrid earthquake and half the size of the Florida hurricane is a lot scary to people. Because even though everybody knows nobody is [ph] out there, nobody really expects to see it in their lifetime.

So I think there is lots of different ways that the market can change. We saw models change markets. We've seen financial crises change markets, we've seen terrorism and I think they'll -- the other thing I would say is what does a changed market mean. I think it's a market where there is more capital coming in. What we have that now is a market where our rates are going up or is it a market where companies are going down and there is insolvencies.

I don't really spend a lot of time worrying about when a market will change. I try to build as much optionality into (inaudible) at levels that we want, regardless of where the market is and regardless of what types of capital are available. We've been building optionality into our business for different types of capital for different rating environments. I'm thinking about it from that context. If the $250 billion happens, I'd imagine that will change the market and Warren probably didn't take a lot of risk in saying that. I also think that we will be there the next underwriting business alongside with (inaudible) that's going back over time what's been a hallmark of ours being one of the first people back in the market writing risk.

Ed Noonan {BIO 1560381 <GO>}

That is in this business the most critical moment is to make sure you've got your doors open in the morning after -- now that's when you get disproportionate benefit. The whole idea that it takes an event to turn the market we just watch the US commercial industry go through its pricing cycle. There wasn't a bloodbath, there weren't a dozen insolvencies, 20 CEOs didn't get fired, returns got unacceptable and kind of stayed there for a couple of years and suddenly there's a gradual upturn in pricing and that upturn seems to be peaking and the second derivative has gone negative but it's still constructive rate environment. And there wasn't -- it didn't take agony, it didn't take big surprises, didn't take -- there is no reason to think that there is any less excess supply available for US insurance and there is the capacity even with pension money coming in et cetera. And so I'm not sure that the concept of an event changing the market is necessarily -- we don't think about it, it's not kind of relevant to us.

Sarah DeWitt {BIO 18946247 <GO>}

Great. Do we have any questions in the audience?

Questions And Answers

Q - Unidentified Participant

Just going back to the topic of the retrocessional coverage what's become cheaper, is there a more hazard risk and were you relying too much on someone else's balance sheet?

A - Ed Noonan {BIO 1560381 <GO>}

I wouldn't say by the way I wouldn't describe it as cheaper. It's become more efficient for us because what's sufficient for us if our outward retrocession might form a very nice part of somebody's overall portfolio. And so I wouldn't describe it as cheap or cheaper and just grown considerably more efficient for us and effective for us. No, I don't see more hazard whatsoever. I mean if you look at market operates on an extraordinary high level of disclosure and we only deal with very sophisticated counterparties so don't see that.

Q - Unidentified Participant

Okay. And then a related question on the alternate capacity, do you see that moving into new areas like flood insurances is that a viable market?

A - Ed Noonan {BIO 1560381 <GO>}

It should be. I have said this a couple of times (inaudible) federal government has no business being in the flood insurance business at this point in time. It was necessary at a point in time, it isn't any longer and the private industry could administer the transition to sound actuarial pricing very effectively and ample capacity available for the risk and I suspect over time the risk would be more efficiently dealt with in the private sector. So yes and that would very much include viable capacity.

A - Kevin O'Donnell

And we write blood many places around the world, US is kind of unique in having a national footprint [ph].

A - Sarah DeWitt {BIO 18946247 <GO>}

Okay, great, why don't we go to the audience response questions. This is a keypad that you in front of you. We'll put up a series of questions. And if everyone can punch in their answers and then we'll show the results straightaway.

Okay. So for the first question, if you currently don't own shares in RenaissanceRe or ValidusRe what would cause you to change your mind and there is a series of responses there?

A - Ed Noonan {BIO 1560381 <GO>}

Thank you for not having a change in management. (multiple speakers)

A - Kevin O'Donnell

I think they are calling [ph] for none of the above. There is no way I want to ever own a stock.

A - Sarah DeWitt {BIO 18946247 <GO>}

Okay. Looks like the winner is 50% improved reinsurance pricing. Okay. Why don't we go to the next question. My confidence level over the next few years in RenaissanceRe or

ValidusRe's ability to deliver a double-digit ROE?

A - Kevin O'Donnell

You had to split this between RenRe ValidusRe to make it much more confusing [ph]?

A - Sarah DeWitt {BIO 18946247 <GO>}

I know. (multiple speakers) Medium confidence is the winner at 49%. But it looks like skewed to the upside with next being high confidence.

A - Ed Noonan {BIO 1560381 <GO>}

What I have observed with 79% of the respondees felt that with medium or better confidence with generating (inaudible).

A - Sarah DeWitt {BIO 18946247 <GO>}

Yes I agree. That's the way to look at. What are your thoughts on that?

A - Ed Noonan {BIO 1560381 <GO>}

I feel -- it makes me feel good.

A - Unidentified Speaker

I am impressed with your math skills. You pulled (multiple speakers)

A - Ed Noonan {BIO 1560381 <GO>}

Actually I'm not really good at simple addition, I'd like to retract that list and I've clearly got the math wrong and a lot of people in the room seem to have confidence.

A - Kevin O'Donnell

Just retake that now.

A - Sarah DeWitt {BIO 18946247 <GO>}

Why don't we go to the next question. Property actually reinsurance pricing for the mid-year 2014 US renewal will be. We also want you to answer that one? It looks like it's pretty evenly split. But more people think it will be down 10% to 15% then 39% thinks down more than 15%. Do you have any thoughts on that?

A - Ed Noonan {BIO 1560381 <GO>}

I think the 17% -- down by more than 15%, that's pretty aggressive.

A - Sarah DeWitt {BIO 18946247 <GO>}

Right. Okay. And let's go to the final question. Alternative reinsurance capital now represents roughly $50 billion, 15% of the global property catastrophe market. How much more could alternative capital grow to in the next few years? 50% think it could be $75 billion or 25%-plus and then it's evenly split between $100 billion or more than $100 billion. What are your thoughts on that?

A - Kevin O'Donnell

Yes, I think it is a distribution so there's and I think $75 billion is a reasonable central point. I think the -- it can dislocate into a lot. It could down to nothing, it could go to be a 100% of the market. I think those are very remote probabilities. I think the thing to think about is as a reinsurer we participate in this type of capital coming in. What's traditionally come in historically is new companies have started which compete with us. So it's a bit of a double-edged sword. This capital is coming in because there's been a large dislocation. We have an opportunity to participate where in the old cycle there was a class of 2001 to class of 2005 which were just competitive forces against us. So regardless of which answer it is, it's kind of -- there's a good side and a bad side as an existing reinsurer.

A - Sarah DeWitt {BIO 18946247 <GO>}

Great. Well. Thank you, very much and everyone please join me in thanking Kevin O'Donnell from RenaissanceRe and Ed Noonan from Validus.