A&M | FINANCIAL SERVICES INDUSTRY GROUP

Capital Efficiency Revolution: How Sidecars Are Transforming P&C Insurance Investment

Opportunity and Drivers

While traditional investments struggle with single-digit returns, reinsurance sidecars are delivering up to 30%+[1] returns to institutional investors. This market surged by 40%[2] in 2024 to reach $10 billion, as investors discovered they can collect insurance premiums with limited downside and 1-5 year exit windows.

Four Forces Created This Perfect Storm

Historically high insurance rates, regulatory pressure on insurers to find external capital, desperate institutional demand for yield[3], and AI-powered[4] risk modeling that makes investment decisions more precise than ever.

Hard market

A reinsurance environment characterized by increased rates and capacity constraints has driven insurers to seek alternative capital solutions.

Investor demand

A growing number of institutional investors, such as pension funds and sovereign wealth funds, have recognized the potential of attractive risk-adjusted returns.

Regulatory capital relief

Heightened interest from re/insurers to reduce their regulatory capital requirements and improve capital efficiency.

Technology advancements

More sophisticated risk modeling and underwriting resulting from enhanced data analytics and AI capabilities make sidecars more attractive to potential investors.

1 Artemis.bm, "Sidecar investors 'handsomely rewarded' for commitment in 2023: Aon," January 5, 2024; https://www.artemis.bm/news/reinsurance-sidecar-market-estimated-at-record-10bn-in-2024-aon-securities/
2 Artemis.bm, "Reinsurance sidecar market estimated at record $10bn in 2024: Aon Securities," September 9, 2024; https://www.artemis.bm/news/sidecar-investors-handsomely-rewarded-for-commitment-in-2023-aon/
3 Insurance Journal, "Hard reinsurance pricing conditions are likely to last longer than in previous market cycles." August 15, 2024; https://www.insurancejournal.com/news/international/2024/08/15/788486.htm
4 Apex Group, "Key trends in Insurance Linked Securities market in 2024," March 11, 2024; https://www.apexgroup.com/insights/what-to-expect-key-trends-in-insurance-linked-securities-market-in-2024/

Participants and Structures

There are three main groups that participate in a reinsurance sidecar, each seeking to achieve distinct benefits:

1 Ceding Company

The re/insurance company that transfers a portion of its risk to the sidecar. Sidecars can support many cedents but are typically limited to one. The ceding company reduces its risk exposure by transferring liabilities to the sidecar, freeing up the balance sheet, and increasing underwriting capacity.

2 Sidecar

The vehicle that holds capital provided by investors. It assumes the specified risks from the ceding company, providing coverage according to agreed terms. Sidecar acts as a vehicle to diversify risk by pooling capital from multiple investors and serves as an efficient way to manage and distribute risk.

3 Investors

Hedge funds, private equity firms, or high net worth individuals are examples of investors who supply the capital for the sidecar. They receive a share of the premiums and potential profits, making it an attractive opportunity to diversify their portfolio with Insurance-Linked Securities (ILS).

Agreement structures between these groups are dependent upon the risk profile of the ceding company, investor preferences, and regulatory environment. That said, quota share, and excess-of-loss are the two most common in the market.

Quota share

The ceding company and sidecar share premiums and losses on a fixed percentage basis. Investors take on a pro-rata share of the portfolio and share in the profits and losses in direct proportion to their capital commitment.

Excess-of-loss

A portion of the ceding company's risk is transferred to the sidecar. Once the ceding company's losses exceed a predetermined threshold, the sidecar assumes responsibility for the excess losses, up to a specified limit. Investors benefit from the sidecar's profits while capping their loss exposure.

Revenue Streams

Reinsurance sidecars present an opportunity for high-yield investments with varying levels of risk appetite, thanks to the sidecars typically shorter durations and adaptable structures. Investors are also attracted to their focused risk portfolio. By underwriting a smaller, more specific book of business, sidecars limit investors' exposure compared to the broader range or risks, insurance types, and geographic areas typically covered by a re/insurance company's entire portfolio.

The primary source of revenue for investors is the share of premiums paid by the ceding company for reinsurance coverage provided by the sidecar. Capital provided by investors is used to generate additional investment income. Investors also receive a portion of the profits from the underwritten policies, which can be substantial if claims are low. Since sidecars often limit investors' exposure to their invested capital, the risk of loss typically equals no more than the amount invested.

A reinsurance sidecar's term is typically one to five years, at which point the SPV is dissolved, and the remaining capital is returned to investors. If successful, however, re/insurers and investors often renew the sidecar to further their partnership.

Design Considerations

When establishing a reinsurance sidecar, several considerations must be addressed to ensure its effectiveness and alignment with strategic goals.

Risk coverage

Determine what risks the sidecar will cover, such as in-force business, new business, or both, and at what levels of quota shares.

Investment strategy

Define the types of assets the sidecar will invest in to ensure organizational alignment with the overall risk and return objectives.

Risk transfer pricing

Establish how the risk transfer will be priced, such as setting the terms of reinsurance premiums and profit-sharing arrangements.

Domicile

Consider regulatory requirements, tax efficiency, and capital structures to inform jurisdiction selection. Bermuda and the Cayman Islands are the most common.

Control

Identify the level of control the primary re/insurer has over the sidecar. Equity stakes can vary, so it is important to define organizational roles in governance and decision-making up front.

Conclusion

The reinsurance sidecar market has evolved into a $10 billion[2] asset class delivering 30%+[1] returns with built-in loss protection. With hard market[3] conditions likely extending through 2027, early movers are positioning themselves in a rapidly expanding alternative investment category.

The Opportunity Won't Last

Elevated rates, uncorrelated returns, and clear exit timelines make this a compelling alternative to volatile traditional investments. Will you capitalize before the market becomes crowded?

About A&M

Alvarez and Marsal's Financial Service Industry Group brings operating, and management expertise combined with top-tier consulting and specialized industry experience to meet evolving market dynamics. We provide transaction and business advisory services on sidecars for re/insurers and private investors, including:

Strategic advisory

Designing and implementing effective reinsurance sidecar structures tailored to the specific needs and goals of the ceding company and investors.

Market intelligence

Conducting thorough market analysis and due diligence to identify attractive investment opportunities and assess the potential risks and returns.

Operational support

Setting up and managing operational aspects of sidecars, including underwriting, claims management, and financial reporting.

Capital raising

Facilitating capital raising efforts by connecting re/insurance companies with potential investors, such as private equity firms.

Performance optimization

Optimizing performance of reinsurance sidecars through data analytics, risk modeling, and performance monitoring.

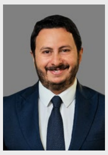
Key Contacts:

Tamseel Butt
Managing Director

tbutt@alvarezandmarsal.com

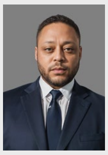
David Carey
Director

dcarey@alvarezandmarsal.com



Solen Soya
Director

ssoya@alvarezandmarsal.com



Chris Taylor
Director

chris.taylor@alvarezandmarsal.com

Raj Venkat
Director

rvenkat@alvarezandmarsal.com

Follow A&M on:

ABOUT ALVAREZ & MARSAL

Founded in 1983, Alvarez & Marsal is a leading global professional services firm. Renowned for its leadership, action and results, Alvarez & Marsal provides advisory, business performance improvement and turnaround management services, delivering practical solutions to address clients' unique challenges. With a world-wide network of experienced operators, world-class consultants, former regulators and industry authorities, Alvarez & Marsal helps corporates, boards, private equity firms, law firms and government agencies drive transformation, mitigate risk and unlock value at every stage of growth.

To learn more, visit **AlvarezandMarsal.com**.