



# Horseshoe Group

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## Introduction to Sidecars

# Disclaimer

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# 2006 Catastrophe Market Conditions

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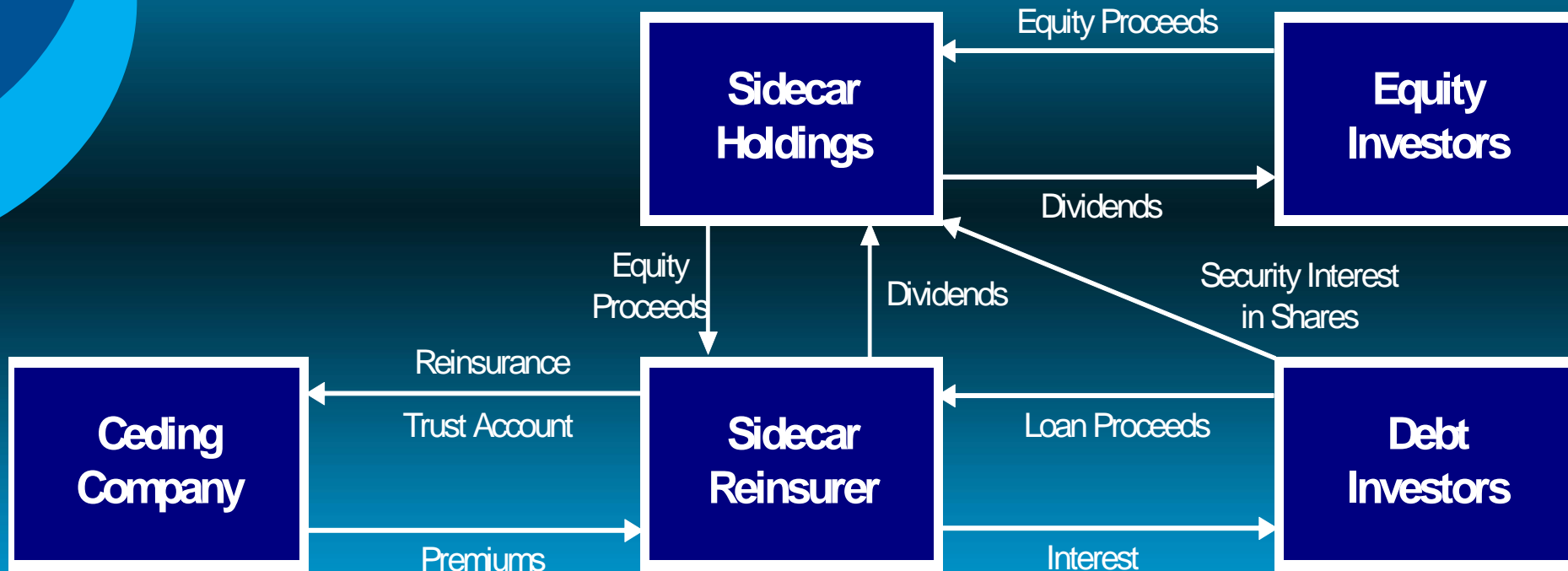
- US wind reinsurance tightest in recent history
- Triple-digit increases in some instances
- Changes in assumptions from catastrophe modelers (RMS, AIR)
- Rating agencies' higher capital requirements for same level of exposure
- Two previous points drove cedants to purchase more cover
- Drying up of Retro capacity

# What is a Sidecar?

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- Not a new concept but more “popular” post-Katrina
- A quota share of reinsurance risk offered to investors
- Fully licensed reinsurance company
- Typically accepts business underwritten exclusively by one reinsurer (Quota Share or Parallel Underwriting)
- Mainly Property and Marine Catastrophe reinsurance
- Capital structure may include Equity, Debt and Preferred
- Typically, Aggregate Limits are fully collateralized
- Override and Profit Commission to cedant
- Limited lifespan
- About \$5b of capital raised for sidecars

# What is a Sidecar? Typical Structure



# Motivations for Forming a Sidecar

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## *Investor's Motivations*

- Quick access to current reinsurance market conditions
- Bank on expected high returns prospectively
- Access to underwriting expertise
- Relative ease of entry and exit
- Short-term commitment: structured to last one or two years
- No need to set up infrastructure
- Asset class diversification and/or Arbitrage
- No legacy issue vs. Equity transaction

# Motivations for Forming a Sidecar

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## **Reinsurer's Motivations**

- Capitalize on franchise value via Override and Profit Commission
- Provide additional underwriting capacity
- Potentially allow for more clout to dictate market terms
- Easier than raising capital
- Avoids dilution of shareholders' equity
- Possible replacement of retro program

## Survey of Bermuda Sidecars

Company	Capital (\$mm)	Sponsor/Management Team
Bay Point Re	\$125	Harbor Point Re
Blue Ocean	\$355	Montpelier Re
Concord Re	\$750	AIG/Lexington
Cyrus Re	\$500	XL Re
Flatiron Re	\$900	Arch Re
Helicon	\$145	White Mountains/Folksamerica
New Point Re	\$250	Harbor Point Re
Norton Re	\$110	Brit
Panther Re	\$360	Hiscox
Petrel Re	\$200	Validus Re
Sirocco Re	\$95	Lancashire
Starbound Re	\$127	Renaissance Re
Syncro Limited	TBD	ICAT/Syndicate 4242
Timicuan Re	\$70	Renaissance Re
Triomphe Re	\$185	Paris Re
Others	Not Disclosed	Various Private Deals

# Framework for Evaluating Sidecar Opportunity

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## *The Cedant*

Items to consider include:

- Importance of due diligence: track record, expertise, processes, models...
- Risk selection, diversification, monitoring of exposure...
- Third-Party monitoring/management or in-house? Any potential conflict of interest?

# Framework for Evaluating Sidecar Opportunity

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## *The Deal Terms*

Considerations include:

- Which risks are ceded to the sidecar
- Alignment of interest
- Override and Profit Commission (level, hurdle, clawback...)
- Collateral requirements and release
- Outward/Inuring Reinsurance
- Commutation terms and conditions

# Framework for Evaluating Sidecar Opportunity

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## *The Results*

Elements to examine include:

- IRR/ROE
- Risk Appetite vs. Underlying Returns
- Realistic Loss Ratio and Cash Flow assumptions?
- All deal expenses reflected (incl. on-going?)
- Attachment Return Period of Equity/Debt
- Basis of Cat modeling and assumptions

# Sidecar Operational Issues

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Several operational issues need to be addressed, among the most important ones are:

- Monitoring of exposures and CAT modeling
- Overseeing Underwriting Activities
- Monitoring collateral and cash flow positions
- Preserving tax-exempt status
- Compliance with contract provisions and underwriting guidelines

# Sidecar Operational Issues (cont'd)

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- Compliance with equity and lender reporting
- Compliance with covenants and warranties
- Board and shareholder meetings organization
- Periodic financial account preparation and Audit
- Actuarial loss reserve evaluation
- Banking/Trustees
- Loss settlements and cash calls

# Sidecar Regulatory Issues

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- Principal Representative role and responsibilities
- Maintenance of records
- Statutory filings and compliance

# Contacts

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