ILS capacity needed to contain the kugelblitz of cyber risks

The traditional reinsurance market needs ILS products to support the growth of cyber insurance. Ari Chatterjee of Envelop Risk discusses the pathway

The meteoric growth of Cyber insurance over the last five years has created a shortage of capacity in the market. With 30% compound growth, traditional reinsurance may struggle to support demand with sufficient capacity, leaving the market ripe for ILS entry. The bigger question is, how?

"There are a few hurdles," says Ari Chatterjee, Chief Underwriting Officer at Envelop Risk, which underwrites as a partner MGA to MS Amlin based out of Bermuda and offers tailored risk-transfer products to the cyber market.

"At present, the primary hurdles are the lack of well-accepted cyber models, an apparent medium tail (two to five years), demonstrated correlations with stock markets, and a lack of specialised underwriting talent," he tells *Reactions*.

While third-party models are improving, none have been accepted as market standard.

"The problem is not with the veracity of the models, but how to implement the short-term shocks in the threat landscape," Chatterjee explains. "We cannot wait a full year for performance data to show us reality has changed when we already have behavioural evidence. We developed an in-house model that navigates the landscape effectively."

Envelop Risk spent several years developing its own AI-based simulation model to quantify cyber risks, approaching the cyber economy holistically. Envelop extends modelling and technology partnerships to its reinsured clients to help grow cyber offerings profitably. "We employ a partnership approach to our clients and capacity," says Chatterjee. "Our philosophy is to help our clients grow their cyber insurance book profitably and we let them benefit from the technology and platform we are building."

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Chatterjee remains positive that the Tail will pose less of a problem since property catastrophe often has a two-to-five-year tail for larger events.

"Most coverages under cyber policies are written on a Claims Made basis, limiting the tail to IBNER. A fronting partner that can offer leverage and collateral rolling is required to make an ILS product work," says Chatterjee.

Cyber events can correlate to the stock market, as publicly disclosed events can directly affect asset prices. This is often cited as the largest roadblock to ILS cyber entry.

"There is ample data to show that good incident response reduces stock market losses, and fortunately most listed firms now carry cyber insurance with strong incident response services. Most stock losses have been temporary, recovering after an initial dip, making case for the long-term investors," he adds.

Specialist underwriters in Cyber reinsurance are a valuable commodity, with just a handful in the market. Chatterjee believes that in next five years there will be more cyber underwriters moving up the chain to reinsurance markets.

Chatterjee suggests that an immediate route of ILS entry to the market is trading ILWs based on PCS cyber index or "Replicat" structures on reported Lloyd's reported loss ratios. Envelop is designing several products that can prove to be valuable to the retrocession market. ILW Products can be based on single losses exceeding a threshold, second/third loss exceeding a threshold, aggregate of all losses reported by PCS/Lloyd's over a year, or even break down the losses in to cause of loss.

"It won't be long before we will witness substantial ILS involvement in the Cyber reinsurance market," adds Chatterjee, who anticipates significant ILS movement within the next six months.