Brighton NEWSLETTER

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Editor's Note

In my last Editor's Note, I wrote about Black Swan events and how the insurance industry needs to be better prepared to deal with future systemic catastrophes.

The recent Suez Canal crisis was another Black Swan event that had major impact on the global supply chain. Analysts believe that the insurance industry could be facing claims in excess of $100 million. These claims would come not only from cargo on board the Ever Given but also from cargoes on ships which voyage was delayed due to inability to transit the Canal.

But how can the industry insure systemic risks that are difficult to predict and model? As proposed by Lloyd's of London, close collaboration among insurers, brokers and customers and governments, is necessary to create new vehicles that combine insurance capital with sovereign capacity to develop protection against systemic risks.

The Suez Canal crisis once again highlighted that changes for the insurance and reinsurance market are long overdue. There is no better time than the present for the industry to explore how best to support a transition to a circular economy, which may hold the key to a more sustainable future.

Annie Undikai,
Managing Director

The Economic Impact Of The Suez Canal Blockage

Back in March, the world was gripped by a skyscraper-sized container ship called the Ever Given that had run aground in the Suez Canal in Egypt. The incident halted maritime operations for a week and caused a chain of aftermath.

Why is the Suez Canal important to the global economy? What is its significance? The Suez Canal provides the shortest maritime route for trade between Europe and Asia. Prior to its construction, ships headed toward Asia had to embark on an arduous journey around the Cape of Good Hope at the southern tip of Africa.

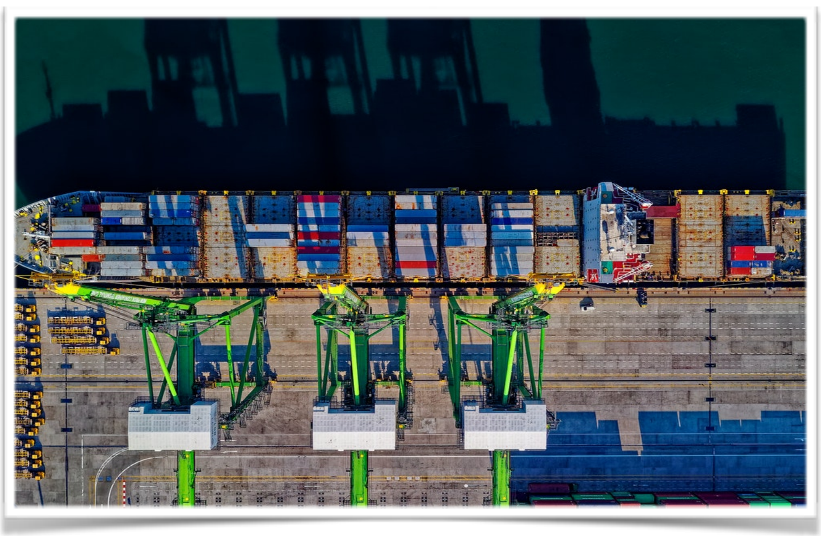
The blockage may not sound too significant to many. But given that the Suez Canal is an essential trade route for world commerce, this accident had serious implications on global trade. Around 12% of all global trade and one million barrels of oil move through the canal every day.

Each day of blockage disrupts more than $9 billion worth of goods, according to Lloyd's List, which translates to about $400 million per hour.[1] And of the 39.2 million barrels per day of crude imported by seaborne methods in 2020, 1.74 million barrels per day passed through the Suez Canal. Global trade was already reeling from the aftershocks of COVID-19. The crisis at the Suez Canal has added more strain on the system and has subsequently affected the global supply chain. As this logjam in the international supply network may play out over many months, this could possibly lead to higher prices and shortages of goods.

The crisis holds some important lessons – from magnitude of the impact, response to the crisis, insurance implications and the vulnerability of global trade. Still reeling from the COVID-19 pandemic, the Suez Canal crisis is yet another reminder of the fragility of global supply chains.[2] Most importantly, the incident highlight the need for better visibility and risk-assessment in global supply chains. For example, businesses must look into developing a risk-based assessment programme that can monitor and measure the impact on supply chain productivity and at the same time support a more flexible and agile network particularly in the face of black swan events, such as the recent Suez Canal blockage.

The incident also highlighted the importance of minimising the risks of mega ships, especially in such waterways, given the disruption that grounding incidents can cause. Mega ships the likes of Ever Given generate economies of scale for ship owners. However, the flip side is that there is disproportionately greater cost when things go wrong not only for the ship owners but for other shipping companies as well as the global supply chain. For instance, the suspension of sailings through the Suez Canal had left shipping companies – including container lines – with millions of dollars in extra costs, which were not covered by insurance.

The blockage is expected to unleash a flood of claims by everyone affected, from those in the shipping industry to those in the commodities business. Total insurance claims from the blockage of the Suez Canal are expected to run into hundreds of millions of dollars as the industry pays out for hefty salvage costs and third-party losses.[3] Cargo owners on board the Ever Given and other shipowners stalled due to the blockage could potentially file claims with both their own insurers and Ever Given's insurer. However, the standard cargo policies protect against lost or damaged goods not the costs of delays.



[1] https://www.cnbc.com/2021/03/26/ship-blocking-suez-canal-is-beginning-to-affect-the-global-economy.html

[2] https://supplychainchannel.co/suez-canal-crisis-over-but-global-supply-chain-impact-to-last-months/

[3] https://www.ft.com/content/0ebac21e-c90d-44db-a4d3-ea1d727b4451

Labuan IBFC and Qatar Financial Authority Ink MoU To Enhance Financial Sector Ties

The Qatar Financial Centre Authority (QFC Authority) and Labuan IBFC Inc had recently signed a memorandum of understanding (MoU) to develop long-term cooperation and boost economic and financial sector ties between the two financial centres.

According to the press release issued by Labuan IBFC, the MoU entails a commitment to collaborate on certain objectives including, but not limited to marketing, awareness activities and identification of mutually beneficial initiatives. Both financial centres also agreed to collaborate on financial sector domains, such as setting up business operations with respect to Islamic finance, digital finance, capital markets, asset and investment management, and other relevant financial institutions and financial service providers within their ecosystems.

The agreement further stipulates facilitating the recognition of banks, insurers, and other financial sector entities in their respective markets, subject to meeting the other jurisdiction's regulatory requirements, and collaborating to explore mutual recognition of regulations for relevant financial institutions via the competent authorities of each jurisdiction.

Both jurisdictions – strategically located in Asia and the Middle East – play a key role in facilitating regional economic growth. Through this collaboration, Labuan IBFC and QFC is expected to further boost economic growth in both regions by unlocking access to new markets as well as expanding and elevating the regulatory recognition of market players in both financial markets.

"This MoU heralds an exciting phase of Labuan IBFC's growth in the MENA region," said Farah Jaafar-Crossby, Chief Executive Officer of Labuan IBFC Inc. She further added that "QFC's legal and operational framework, as well as its adherence to international standards of transparency and regulatory robustness, provides an ideal platform from which our intermediaries may leverage towards making inroads into the MENA region."

Source: Labuan IBFC Press Release "Qatar Financial Centre Authority signs MoU with Labuan IBFC Inc enhancing Asia and MENA financial sector ties'. Available at https://www.labuanibfc.com/resource-centre/media/labuan-ibfc-inc/qatar-financial-centre-authority-signs-mou-with-labuan-ibfc-inc-enhancing-asia-and-mena-financial-sector-ties

The Growing Market For Run-Off

The market for run-off or legacy business has evolved, particularly over the past five years, and has developed into a key component of the global insurance market. As the threat of the global recession looms post pandemic, this market is expected to take centre stage in 2021.

Historically, run-off was used as a means to distinguish contracts that are cancelled on a cutoff basis, where the reinsurer is not liable for losses taking place after the date of termination.

Today, the term "run-off" has been expanded to include the entire books of business, the insurance or reinsurance company itself and the entire sector of the market in which such business is administered.

According to PwC's Global Insurance Run-off Survey 2021, the run-off market grew in 2020 and became even more relevant as a solution for entities with legacy exposure.[1] The global run-off reserve was estimated to have increased from $791 billion to $864 billion; representing a 9% increase.

The report highlighted that the run-off market in the emerging economies continued its growth trend on the back of greater demand for personal lines and liability insurance. However, PwC estimated that new opportunities rising from the Middle East are expected to reach $13 billion in run-off reserve this year. Total run-off liabilities in key markets across Asia, the Middle East and South America, are estimated to have a combined liabilities of $160 billion in 2021

Majority of survey respondents (about 60%) believed the global legacy market is still in its growth stage of its evolution. This implies that legacy management is further growing, as it integrates itself into the traditional insurance life cycle.

Respondents further indicated that they expect the run-off markets to be heavily influenced by several factors including increased levels of capital availability and hardening market conditions. Whilst 93% of respondents believed that new capital will continue to be made available to legacy market players in the current hardening market.

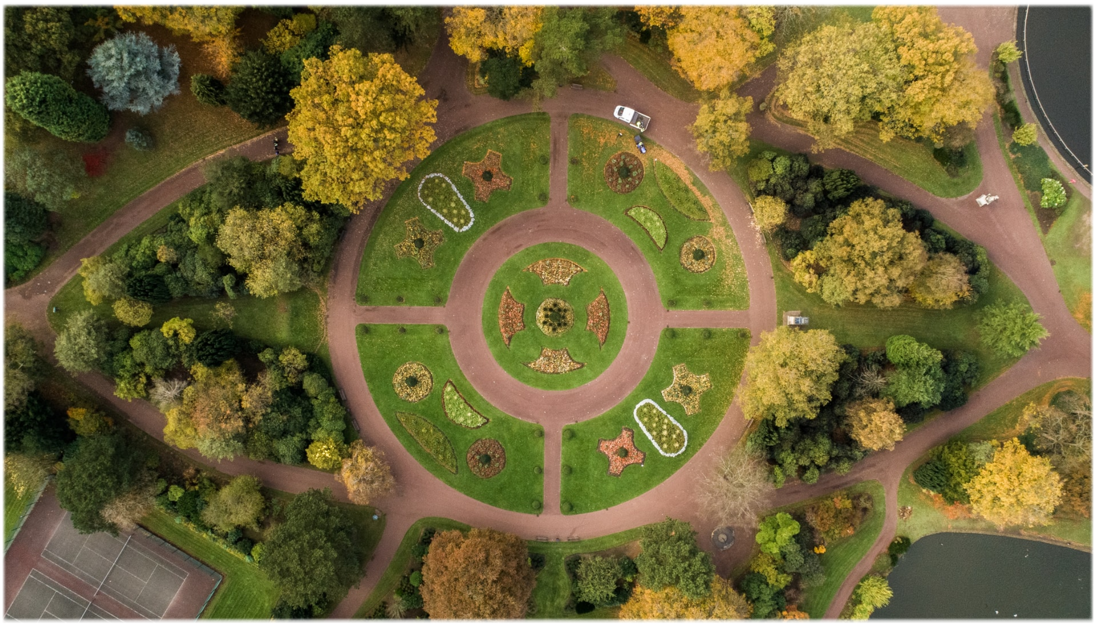
[1] https://www.pwc.com/gx/en/financial-services/assets/Global-Insurance-Run-off-Survey-2021/global-insurance-run-off-survey.pdf

How The Insurance Industry Can Drive The Shift Towards A Circular Economy

One year has passed since COVID-19 was first declared as a global pandemic. The impact of the pandemic continues to fuel a global health crisis and unleash social and economic storms across the globe. The current situation has exposed systemic flaws on our linear economic system where resource extraction and waste production have caused widespread environmental degradation, climate change, loss of biodiversity and pollution.

The science is clear: if we continue destroying our ecosystems, COVID-19 won't be the last global pandemic we are going to experience. If there is one thing we can learn from this pandemic is that we need to drive a wider economic transformation that is more resilient against future global risks, and sustainable and inclusive in nature. With the impact of climate change and recent international push to reduce waste consumption is a top-of-mind concern, there is a strong push towards adopting a circular economy to avert the dangers associated.

What is circular economy and how does it work? Circular economy refers to a model in which economic growth does not go hand in hand with the exploitation and consumption of natural, non-renewable resources.[1] The aim of this economic model is the resource-efficient and sustainable use of natural resources, their reuse and recycling within a circulatory system and the prevention of waste. Moving to such a model could reduce waste, improve resource productivity, and better manage resource scarcity. But this entails a culture-wide rethinking of the way businesses design systems to handle resource and the ways they build networks and partnerships. On the part of consumers, they need to fully embrace conscious consumption practices and green products' demand. Hence, for the circular economy to take root, there must be a shift in thinking from an economy that extracts value to one that creates value.



[1] https://sphera.com/glossary/what-is-a-circular-economy/

Supporting the circular economy is a real opportunity for the insurance industry to initiate a global transition toward a more sustainable economy that combines growth with environmental sustainability. For instance, insurers have a key role to play in driving the shift to a circular economic model by promoting sustainable approaches to climate-resilience. Insurers can encourage sustainable choices and outcomes by offering financial products that contribute to the circular economy, conserve natural resources and avoid or reduce waste.

A case in point is AXA, which have been investing in the circular economy since 2016. Through its impact investment funds, AXA selects assets based on financial returns as well as their positive social and environmental impact such as the Circularity Capital's European Growth Fund, which is dedicated to the circular economy.

Governments, on the other hand, should provide incentives and an enabling policy and legislative framework to accelerate the integration of circularity into insurance products. For example, government can implement COVID-19 recovery strategies that embed circularity in economic growth as well as policies, laws and related instruments to address systemic barriers to circularity.

The United Nations Environment Programme (UNEP) has recently published several recommendations for financial institutions to boost circularity. In its latest report titled "Financing Circularity: Demystifying Finance for the Circular Economy," UNEP outlined how financial institutions can help redesign global economies by changing the way we consume and produce, which includes the following recommendations:

- Integrating circularity into their core business strategies and increasing their assessment of environmental, social and governance (ESG) criteria
- Setting targets on resource efficiency
- Re-orienting loans and investments towards more sustainable technologies and financing innovative business models,
- Making financing circularity an opt out rather than an opt in in mainstream financial instruments,
- Evaluating how financing for circularity can contribute to the implementation of key financial industry frameworks such as UNEP Finance Initiative's Principles for Responsible Banking and Principles for Sustainable Insurance.

The shift to a circular economy offers a $4.5 trillion economic opportunity by reducing waste, stimulating business growth, and creating jobs. Based on the assessment made by the International Resource Panel of the UNEP, sustainable use of materials and energy could add an extra $2 trillion to the global economy by 2050. Hence, making better use of raw materials is not just good for the planet, but is also a financial imperative.

[2] https://www.unepfi.org/news/circular-economy/driving-the-shift-to-circular-economies-new-report-on-role-of-finance-industry/

[3] https://www.hellenicshippingnews.com/3-reasons-why-embracing-the-circular-economy-can-be-powerful-for-middle-income-countries/

Wishing our Muslim clients and friends a joyful Eid.

Eid Mubarak

From all of us at Brighton International Group

Eid Vectors by Vecteezy