Brighton NEWSLETTER

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Editor's Note

In many countries, restrictions have begun to loosen up with vaccination roll outs gaining momentum. As we slowly return to some version of a pre-pandemic life, we must remain mindful and not loose sight of another growing threat on the horizon – climate change.

Failure to mitigate and to adapt to climate change is the biggest global risk. The World Economic Forum has identified climate action failure as the most impactful risk and the second most likely long-term risk.

In this issue, we feature an article on how captives can be used to mitigate climate-related risks and improve company's climate resilience.

We also present a snapshot on the 2022 global outlook for the reinsurance sector. Overall, a stable outlook of the sector is supported by a number of key driving factors, including fresh demand for reinsurance as the global economy recovers next year.

This issue also captures the lengthy discussion on the formation of captives in Labuan and the benefits these self-insurance vehicles have to offer, during the recent webinar on Labuan IBFC: A Growing Domicile for European Risk Owners.

I hope that this month's issue gives our readers food for thought. Until next month, happy reading!

Annie Undikai,
Managing Director

Global Reinsurance Outlook 2022

The global reinsurance market has continued to show robustness and resilience in the face of persistent adverse conditions in the real economy – economic downturn, social inflation, heightened catastrophic activities, and the global COVID-19 pandemic. This resilience is expected to continue in 2022.

Moody's Investors Service had recently revised its outlook for the global reinsurance sector from negative to stable as a result of increasing reinsurance prices and solid capitalisation.[1] The report by Moody's highlighted that healthy price increases is expected to drive stronger earnings for the sector through 2022 due to post-pandemic economic recovery and the recent significant catastrophe losses fuel fresh demand for reinsurance.

[1] https://www.moodys.com/research/Moodys-Reinsurance-outlook-changes-to-stable-as-sector-raises-prices--PBC_1301569?cid=7QFRKQSZE021

It further highlighted several key factors that are driving stronger earnings for the sector in 2022. Amongst them are the rise in property reinsurance prices on the back of recent natural catastrophe losses as well as the re-evaluation of secondary peril risks. Stronger earnings will be driven by demand for reinsurance as the global economy rebounds. Moody's also noted that recent significant catastrophe losses will further fuel fresh demand for reinsurance, which in turn will support the sector's earnings through 2022.

However, the report cautioned that economic recovery post-pandemic will likely push up claims. But as frequency and severity of natural disasters increases, partly due to climate change, underwriting profitability will be harder to attain.

In its 2022 Outlook: Global Reinsurance report, Fitch Ratings expects improvements in reinsurers' financial performances in 2022, amidst the backdrop of higher prices in a hardening market, strong rebound in economic activity, lower pandemic-related losses and higher demand for reinsurance. [2]

The report further stated that these 3 drivers are expected to outweigh the unfavourable effects of falling investment returns, rising natural disaster claims attributable to climate change, and a brief pick-up in inflation. With regard to global uncertainty in pandemic losses, Fitch outlined 3 main reasons why this is waning.

First, vaccination progress has lowered the danger of extra mortality claims in life reinsurance. This is despite the spread of delta variant, which is more transmissible as compared to the other variants.

Second, the exclusion of infectious disease in renewed contingency and business-interruption treaties have mostly eliminated the risk of new pandemic-related claims of these business lines. Third, the business-interruption losses reported thus far this year have been within expectations factored into incurred-but-not-reported claims reserves set aside in 2020.

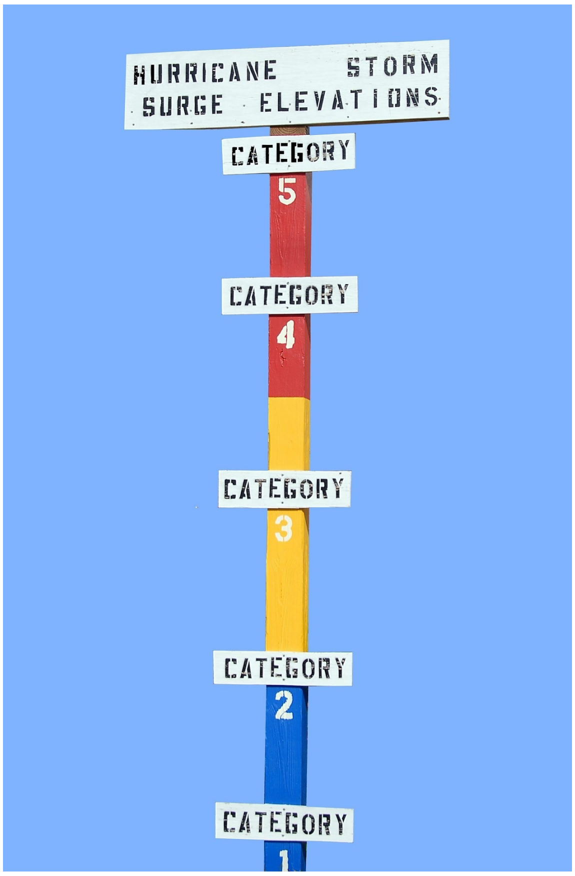
The stable outlook for the reinsurance sector was echoed by A.M. Best as improved pricing trends for the majority of business lines is set to offset increasing claims uncertainty. [3] As for insurance-linked securities (ILS), the market is expected to remain resilience due to increase in catastrophe bond issuance and firm pricing discipline in the collateralised reinsurance market.

[2] https://www.fitchratings.com/research/insurance/fitch-ratings-2022-outlook-global-reinsurance-07-09-2021

[3] https://davies-group.com/knowledge/why-reinsurance-is-fundamentally-important-in-protecting-a-firms-exposure-to-a-specific-risk-or-catastrophic-event/

Mitigating Climate Change Risks via Captives

Climate change is much more than just an environmental issue. In recent years, companies are already experiencing the impact it has on businesses, and this is expected to continue to have an even larger effect moving forward. Increased risks due to extreme weather, changes in resources availability and costs, changing regulations and increased public pressure; are some of the climate change related issues that are impacting the day-to-day operations of companies world over.



Businesses are now increasingly exposed to new and unpredictable risks as the result of climate change, which are affecting natural and human systems. Climate change risks include physical risks, litigation risks, reputational risks, stockholder risks, regulatory risks, and competition risks.

As reported by the Global Risks Report 2021 climate change continues to be a catastrophic risk.[1] The report revealed that among the highest likelihood risks in the next 10 years are extreme weather and human-led environmental damage; whilst climate action failure and other environmental risks are among the highest impact risks of the next decade.

Companies are increasingly being pressured by stakeholders to take more actions to address climate change, as reported by Deloitte in their European CFO Survey.[2] Mounting public awareness, fanned by more frequent extreme weather events and the growing weight of scientific evidence on changing weather patterns,[3] have further added to the urgency of the debate on climate change. Climate change events such as floods, tropical storms, droughts, pollution and sea level rise have led to contingent business interruption losses, from physical damage to global supply chain disruptions and impacts on healthcare. These are hugely prominent risk for many businesses. Although these events may be insurable, they are often either too difficult to insure on the commercial markets or are too expensive to be insured.

[1] http://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2021.pdf

[2] https://www2.deloitte.com/us/en/insights/topics/strategy/impact-and-opportunities-of-climate-change-on-business.html

[3] https://www.munichre.com/topics-online/en/climate-change-and-natural-disasters/climate-change/climate-change-heat-records-and-extreme-weather.html

Towards this end, captives can provide support for those lines of business that are exposed to the negative impacts of climate change events, especially where commercial insurance is deemed too expensive, less cost-efficient or in the event where certain coverage is not available in the commercial market otherwise. Through the formation of captives, companies have access to reinsurance markets and alternative capital markets to fund climate change related risks. In addition, a captive can act as a risk-financing vehicle that, over time, builds up surplus to pay for more catastrophic risks, which aids in reducing cash flow volatility and decrease budget uncertainty.[4]

Captives, through their customisable coverage and flexibility, make them a suitable risk management tool for mitigating emerging risks such as climate change risks, which are often unquantifiable, difficult to price and lack commercial market solutions. As captives can act as a conduit to transfer climate change risks to the insurance or reinsurance market, they can potentially improve companies' climate change resilience. Although climate change is a long-term phenomenon, one cannot deny the short term impact it has on businesses. For these reasons, companies must take action to improve their resilience by writing coverages for business interruptions, catastrophic losses and supply chain disruptions into captives as a means to mitigate and protect their businesses against such climate-related risks.

Even though parametric solutions for captives are still in their infancy, demand has been growing. For example, the use of captives as a mechanism for structuring parametric weather insurance has steadily increased in recent years as companies are forced to take on more catastrophe related risks. This trend is expected to continue with the hardening of the insurance market. In a recent development, Arbol, an InsureTech platform, launched a 'Captive+Parametric' solution for climate change risk management. Through this solution, companies can transfer climate risks into captives using a parametric structure.

As climate change threatens to bring more extreme events and severe weather events become a greater point of global concern, risk management framework will need to account for risks related to climate and weather. In this regards, captives need to be considered as an appropriate risk management tool to mitigate climate-related risks and improve company's climate resilience.

[4] https://www.greenbiz.com/article/how-use-captive-insurance-mitigate-climate-change-risks

Labuan IBFC: A Growing Domicile for European Risk Owners

Labuan IBFC recently hosted a webinar focused on Labuan as a growing jurisdiction of choice for European risk owners. Moderated by Farah Jaafar-Crossby (CEO, Labuan IBFC Inc.); the webinar included panel experts who shared their insights on the topic. Panellists included Oliver Schofield (Managing Partner, RISCS), Annie Undikai (Managing Director, Brighton International Group), Daniel Landen (Managing Director, Protected Trust Services) and Ridzuan Ariffin (Strategic Solutions Director, Principal Re).

During his presentation, Oliver Schofield highlighted that Labuan is a well established leading insurance and reinsurance destination of choice for some of the largest global insurance and reinsurance companies. With home to over 50 captives and a growing number of cell captives, Labuan has now become a very important captive domicile in the Asian region. He further stressed that the jurisdiction is the only Asian domicile with a captive and cell captive legislation.

As a midshore domicile, Labuan is a self-regulated financial centre with an independent regulator, but has a robust regulatory and fiscal ties with Malaysia as the home country. This is similar to Gibraltar in the UK and Gujarat in India.

Schofield presented 5 key points on why Labuan should be a domicile of interest to European companies. Having established a few cells in Labuan for non-Asian businesses, he added that these were also the reasons why their clients were attracted to Labuan as a domicile. First, with a robust regulatory regime, Labuan has the capability to host and provide the appropriate solvency and capital protection that are needed for the captive sector. Second, Labuan has a highly developed support infrastructure, which makes it very easy to do business in the jurisdiction. In his own experience, Schofield shared that the speed of being able to open bank accounts and to get application processed and submitted to the regulator for consideration have been very favourable with their European clients.

Labuan also offers a fast track authorisation process, which means that the whole application can be turned around within 14 days. He added that this is particularly important in the market where decisions have to be made fairly close to renewals and having that fast track process is of significant important. He went on to stress that this is the most significant development and innovation in cell captives over the last 25 years as the fast track or pre-authorisation process has improved the speed of establishing captives.

Another attractive consideration in choosing Labuan, especially to European clients, is its competitive cost base of doing business. The requirements for capitalisation in Labuan are much more competitive than other jurisdictions, whilst the cost of engaging managers, lawyers, accountants and others within Labuan's jurisdiction is considerably lower than in many other jurisdictions.

According to Schofield, Labuan is considered as being the Asian captive and cell captive domicile as it is the only domicile in the region that has a specific cell captive legislation. He further pointed out that all these factors have heightened interests from European-based risk owners, who are seeking solutions for their risk profiles when considering Labuan as their domicile of choice for captives.

During the panel discussion, Daniel Landen shared his experience of establishing a cell captive in Labuan. Although cost was an important consideration, control over dictating your own terms was deemed more critical. He explained that through captives, the company was able to have a policy that actually fits its needs rather than getting the company to fit within a given policy.

On fronting considerations, Annie Undikai explained that Labuan does not impose any rules on this, instead this is dependent on the receiving country and where the risk is coming from. For example, if a company has a captive in Labuan and writing into the EU, then the company will need to have an EU front as per the rules imposed by the EU. So from Labuan's perspectives, if the receiving country does not require a front or licensed insurer in that particular country, then a front is not needed.

Commenting on the hardening market, Ridzuan Ariffin said that based on the insurance market outlook, the hard market is not going away anytime soon and is expected to continue well into 2022. Under such market environment, clients are being forced to consider alternative risk financing options. For this reason alone, Ariffin noted that a captive structure, be it temporary or long-term, will deliver solutions irrespective of the current market conditions. Undikai added that companies are already self-self-insuring their own risks anyway, but captives offer a formalised form of self-insurance. In this regards, once a business understands what a captive is and the benefits it offers, businesses will continue to demand captives regardless of market conditions.