Brighton NEWSLETTER

You insure, We ensure

Editor's Note

For organisations, the term 'business as usual' is now regarded as an archaic term, made redundant by net zero and other sustainability initiatives. As an industry, insurance has a significant role to play in the road to net zero by 2050. Can a net zero future be achieved without net zero underwriting? Our first article in this August issue explores the matter at hand.

Our next article focuses on water-related risks. The World Economic Forum warned that the financial impact of water risks could be as high as five times greater than the cost of addressing them at present.

Even though water risks are regarded as one of the top risks facing businesses, the jury is still out there when it comes to assessing the impact of water on financial risks.

The article on tragedy of commons sets to shed further light into how this old century economic theory applies to sustainability issues as we know it.

The month of August is a special month for us Malaysians as we celebrate our Independence Day on August 31. On behalf of all of us at Brighton, may I wish Happy Merdeka to every Malaysians, here at home and abroad. May the Jalur Gemilang fly high in all your hearts wherever you may be.

Annie Undikai,
Managing Director

The Road To Net Zero Underwriting

Reaching net zero is critical in limiting global warming to 1.5 °C as set out under the Paris Agreement. This requires transformative change in societies, businesses as well as governments. Key to achieving net zero target is engagement and collaboration between all stakeholders to support innovation and investment in zero-carbon technologies and solutions.

The road to net zero, however, begins with decarbonising the economy. This is where the insurance industry plays a vital role in accelerating the transition to a net zero economy by 2050. With $36 trillion in global assets under management, the industry has a considerable influence over business decision making in its role as risk carriers, risk managers and enablers of economic activities. It is also uniquely positioned to provide innovative products and services to finance, manage and protect against the rapidly changing risk landscape that customers face as they transition towards a low carbon future.

However, for the insurance industry to achieve a net zero future requires net zero underwriting. What does net zero underwriting mean? What does it look like in practice?

The concept of net zero underwriting builds on the established need for "climate-ready" insurance products. At present, net zero underwriting is still an evolving area with no standard methodology or definition. In developing a methodology to underwrite the climate change transition, it is imperative to establish a common global standard to assess, understand and disclose carbon intensity of underwriting.[1]

Towards this end, the Net-Zero Insurance Alliance (NZIA) is working with the Partnership for Carbon Accounting Financials (PCAF) to establish a common emissions measurement methodology for the industry. The methodology centres on key technical decisions around measuring absolute versus intensity-based emissions metrics, the role of differing attribution factors, the extent double counting can be mitigated, and availability of specific emission data.[2]

In order to propel net zero underwriting practices, a report published by ClimateWise outlined key considerations, including:[3]

- Setting emission scope boundaries for the insurance industry.
- Measuring net zero alignment with carbon foot printing, transition pathway evaluation and temperature score.
- Understanding net zero implications for each insurance underwriting line of business.
- Reacting to different insured clients, assets and activities.

The considerations recommended by ClimateWise, however, require a detailed view of the insurance value chain. This in turn would lead to a greater understanding what net zero means to each stakeholder involved in the underwriting activity.

But in achieving net zero insurance, the industry faces three main challenges: (1) raising awareness of what it means to be a net zero insurer; (2) engaging with stakeholders about the importance of a zero carbon economy; and (3) developing a methodology and tools for determining what makes a net zero insurer.[4]

The road to a net zero value chain is a complex process that requires transparency, data-sharing and collaboration. Achieving innovation that is needed to achieve net zero targets will require collaboration between government, local authorities, business leaders, the public and other stakeholders.

1 https://www.globalreinsurance.com/home/insuring-the-transition-to-net-zero/1440666.article
2 https://www.unepfi.org/psi/wp-content/uploads/2021/01/PSI-TCFD-final-report.pdf
3 https://www.cisl.cam.ac.uk/news/climatewise-report-outlines-ways-insurance-underwritings-support-net-zero
4 https://riskandinsurance.com/insuring-the-climate-transition-3-key-actions-the-net-zero-insurance-alliance-is-taking-to-globally-reduce-emissions/

Framing Water As A Financial Risk

Leonardo da Vinci aptly summed up water's importance when he said; water is the driving force of all nature. Water, clean water in particular, is essential to life. However, pollution, overconsumption of water, population growth and climate change are making clean water an increasingly scarce resource, putting business and economic growth at risk. The World Economic Forum’s Global Risks Report highlighted that microscopic particles of plastic waste were found in 83% of tap water supplies, and people eating seafood could be ingesting up to 11,000 pieces of microplastic each year.[1]

Climate change is also accelerating and exacerbating water quantity and quality risks. Reports published by World Bank suggest that water scarcity compounded by climate change, could hinder economic growth, spur migration, and spark conflict.[2] According to CDP, a non-profit international organisation that runs the global environmental disclosure system, global companies in key industries are already losing billions as a result of the global water crisis. CDP reported that that $13.5 billion in assets are potentially stranded and a further $2 billion are at risk due to water issues, including those related to water quality.[3]

Water scarcity is an important type of physical water risk that portfolio managers and investors should consider when building investment strategies. However, lack of standardised, consistent and reliable data; are restricting investors from making well-informed investment decisions around the financial risks of water impacts.

[1] https://www3.weforum.org/docs/WEF_GRR18_Report.pdf

[2] https://www.worldbank.org/en/topic/water/publication/high-and-dry-climate-change-water-and-the-economy

[3] https://cdn.cdp.net/cdp-production/cms/reports/documents/000/006/321/original/High_and_Dry_Report_Final.pdf?1651652748

To elevate water risk as a financial risk, Ceres, an environment-focused shareholder advocacy organisation; and a group of institutional investors launched the Valuing Water Finance Initiative to encourage the biggest corporate water users and polluters to act on their water stewardship.[4]

This new global investor-led effort aims to drive the necessary large-scale change to better protect water systems by engaging with 72 of the world's biggest companies on sustainable water practices and water risks. The initiative will focus on seven core actions: water quantity; water quality; protection of the ecosystem; access to water and sanitation; board oversight; public policy engagement; and multi-stakeholder collaboration.

The World Economic Forum (WEF) warned that the cost of water risks to business could be more than five times greater than the cost of acting now to address those risks.[5] Failure to account for water security in financial decision making could lead to significant financial flows that could potentially increase the exposure and vulnerability to water-related risks across the global economy.

According to the WEF, water risk is a systemic, material risk that is causing significant economic and social costs; which not only threatens asset prices but also undermines progress towards the United Nation's Sustainable Development Goal 6 on water and sanitation.

A key to tackling the growing water crisis for institutional investors such as pension funds and insurance companies is to enhance their financial analysis by taking a more systematic approach to evaluating water-related financial risk. Towards this end the Corporate Bonds Water Credit Risk Tool was developed to address the need of investors to systematically integrate water resource constraints in their decision making process and translate exposure to water-risk into a quantified financial risk.[6]

[4] https://www.ceres.org/water/valuing-water-finance-initiative

[5] https://www.weforum.org/agenda/2022/07/finance-water-crisis/

[6] https://vfu.de/water-risk-tool/

Business Sustainability: Tragedy of the Commons

The tragedy of the commons is an economic theory that was first conceptualised in 1883 by William Forster Llyod. The theory refers to a situation in which individuals with access to common or public resources act in their own interest and in doing so, ultimately deplete these resources. This theory is used extensively to explain an individuals' tendency to make decisions based on their personal needs without considering the best interest of others or the negative impact that decision may have on others.

From a sustainability point of view, when something is owned by a group (not privately owned), the overall sustainability may be impacted because no single person technically owns it or is responsible for it.[1] The tragedy lies in the fact that in the absence of well-defined property rights or rules in the exploitation of a common resource, selfish and rational human nature will lead to the depletion of essential resources.

Thus, the tragedy of the commons applies to almost all issues of sustainability and should be understood as a fundamental framework in addressing these issues. Driven by their survival instinct, humans are often motivated to act in their own self-interest, and ultimately over consume in the long run. Long term over-consumption of our limited natural resources leads to environmental degradation and negative impacts on our society.

We see the tragedy of the commons play out over and over again as we examine environmental, social, and economic sustainability issues. Is there a solution to this tragedy? Can we reverse it? One way is to develop a more sustainable mindset for both individuals and corporates. An important skill of a sustainable mindset is the ability to imagine different futures and to evaluate how sustainable they would be and how to get to the desired future. Hence, a sustainable mindset is not only essential for survival, but can also drive innovation in organisations of all shapes and sizes.

For the insurance industry, sustainable mindset entails thinking about sustainability through both an underwriting and an investment lens. In other words, insurers must collectively as an industry wear multiple hats – as an underwriter, an investor; and engaging clients on ESG matters when addressing sustainability issues.

1 https://www.integratesustainability.com.au/2018/02/02/tragedy-of-the-commons-environmental-management #:~:text=It%20was%20first%20coined%20in,or%20is%20responsible%20for%20it.

Event Highlights

August was another busy month for us here at Brighton!

The 5th Asian Captive Conference 2022 was held on August 18 in Kuala Lumpur. As one of the conference sponsors, Brighton was proud to have contributed to the discussions and exchanges of ideas, particularly on the topic of captive insurance.

This year's conference carried the theme "Embracing Change and Accelerating Growth: The Way Forward for Self-Insurance", which was not only timely but also highly relevant given today's challenging economic and business landscape.

The theme aimed at highlighting how risk professionals are embracing the changes in captive insurance and the increase utilisation of self-insurance in response to changing insurance market conditions.

As highlighted by speakers, companies are now increasingly facing risks that are not only complex in nature but unique to their business. This has forced them to explore alternative ways of transferring such risks in a cost effective and efficient manner. In this regard, self-insurance as an alternative risk finance mechanism, has gained attention as the go-to solution.

The Head of Commercial Operations at Brighton Management Limited, Mr Nazri Wong Abdullah, gave an insightful talk on captive and its many benefits. He also touched on the formation of Shariah-compliant captives in Labuan.

He added that amongst permitted business activities for a Shariah-compliant captive incorporated in Labuan included underwriting of direct general or Family Takaful business risk of the group.

Other topics deliberated during the conference were development of captives in Asia, OECD BEPS and its impact on captives, role of captives in ESG initiatives, and benefits of establishing protected cell companies. Also present were Ms Annie Undikai, Founder and Managing Director of Brighton International Group and Miss Han Yee Yuen, General Manager of Brighton Management Limited.

In a separate event, Mr Nazri Wong Abdullah shared his extensive and deep knowledge on the formation of captives in Labuan IBFC to the business and financial communities in Cambodia. Speaking at a seminar organised by the Malaysian Business Chamber of Cambodia (MBCC) in Phnom Penh; he highlighted that Labuan IBFC is the only jurisdiction in Asia that provides for the protected cell company (PCC) structure; both conventional and Shariah-compliant.

The seminar was part of a two-day official visit (24 -25th of August) to Cambodia to promote Labuan IBFC as the preferred international business and financial centre in Asia. The delegation comprising of several officials from Labuan IBFC and key industry players was headed by Datuk Iskandar Mohd Nuli, Executive Chairman of Labuan IBFC.

During the visit, Mr Nazri Wong Abdullah and other delegates also met with several key government officials and business leaders including the Director General of National Bank of Cambodia, Director General of Insurance Regulator of Cambodia and CEOs of various financial institutions such as HH Bank, Credit Guarantee Corporation of Cambodia, Cambodia Life, CB General Insurance Plc and APD Bank.

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and Financial Centre, Malaysia