Catastrophe & Agriculture Reinsurance Finance in Shanghai's Free Trade Zone

by JOHN AND DAI MIN MILLIGAN-WHYTE

China Insurance Regulatory Commission and China and Bermuda's Ministries of Finance working together with Chinese and Bermuda companies in the Shanghai Free Trade Zone (SFTZ) can enable Chinese government entities to commercially transfer, finance and hedge catastrophe and agricultural losses in the reinsurance, capital and commodities markets. This is the second in a series of monthly articles on why and how this can be achieved.

Bermuda's Ministry of Finance began creating the world's leading "special economic zone" for insurance and reinsurance in the 1980s. By 2005 Bermuda was the world's second largest reinsurance market receiving 11% of the world's reinsurance premiums. With the rapidly increasing frequency and severity of economic losses caused by natural catastrophes since 1992, Bermuda reinsurance companies now provide US$2 trillion of the US$3.5 trillion catastrophe reinsurance coverage available globally.

Bermuda made itself into the world's most attractive jurisdiction for the companies providing reinsurance and insurance linked securities finance (known as "ILS") by developing the world's most effective insurance and reinsurance regulatory system. Bermuda became the best-regulated jurisdiction for Wall Street and sophisticated investors to set up highly capitalized and rated new reinsurers quickly.

China and Bermuda's Strategic Partnership in Shanghai's New Free Trade Zone

China's insurers and reinsurers business can profitably develop with Bermuda reinsurers as their strategic partners in providing China's catastrophe and agriculture insurance and reinsurance products and coverage. Providing the coverage China urgently needs to protect its economy also requires far more reliable and highly capitalized reinsurance capacity than currently exists in the international insurance, reinsurance and ILS markets.

China Investment Corporation's assets of US$585 billion and the State Council's estimate that China's insurance and reinsurance premium payments in 2015 will reach US$484 billion annually are already larger than the total assets of US$480 billion of the world's 200 reinsurance companies and US$48 billion capacity in the ILS markets.

China can Protect Itself by Becoming the Largest Consumer, Provider and Investor in Agriculture and Catastrophe Reinsurance and ILS finance

China's agriculture and catastrophe risk exposures and peak losses are far too large to be reliably provided by the capital in the international reinsurance market. Such massive and volatile loss exposures need to be financed and hedged in the global capital and commodities markets using the new asset class of insurance linked securities, which are already providing 20% and may grow to provide 50% or more of the capital providing catastrophe recovery costs protection.

China has the world's highest exposure to earthquake risk and huge urban concentrations of people and industry. In 2006 the State Council's "Opinions on the Reform and Development of the Insurance Industry" made it clear that China should establish a national financial support system for catastrophe insurance. But, eight years later, Yunnan, Shenzhen and Ningbo are the only three sites that have been approved as catastrophe insurance pilot areas. Shanghai, Beijing and Guangzhou produce 60% of China's GDP and 90% of its exports.

Less than 1% of China's earthquake recovery costs are covered by insurance, which hinders and delays reconstruction. Combining China's capital and urgent need for protection with Bermuda's successful regulatory experience is required to safely design and scientifically manage the massive catastrophe and agriculture insurance and reinsurance coverage China needs. The long-term reconstruction costs of a peak loss or losses, if uninsured, can trigger fiscal and economic crises beyond the management abilities of local, provincial and national government bodies already overwhelmed by a catastrophe's immediate relief and recovery costs.

Huge earthquakes of 8.6 and over on the Richter scale come in 15 year cycles. We are in an 8.5 cycle and as a result of the 2011 Japanese earthquake there is an 81% to 93% probability of a major earthquake hitting Tokyo. Japan's Cabinet Office estimates that would cause US$1 trillion in insured losses, which is more than all the assets of the global reinsurance market. It will also trigger further uninsured losses of US$1.7 trillion. Earthquakes occur in interrelated regional clusters. Such a peak loss or a series of major losses will bankrupt many of the world's insurance and reinsurance companies and trigger capital and credit market crises and collapse of international trade supporting China's economy.

Trillions of dollars of additional liquid capital reserves are needed to reliably finance the insurance and reinsurance needed to protect China's national security. China's scientific management of its economy has resulted in US$3.83 trillion foreign currency holdings that China needs to circulate in the global economy and profitably invest.

Bermuda Companies are Safer Partners than European and American Companies

Bermuda companies are the best partners for China's insurers and reinsurers seeking to develop international expertise and business. America has now threatened to use economic sanctions and military force if China attacks or coerces nations disputing China's territory claims. The reliability of American and European controlled companies is highly exposed to American and European regulatory attack, economic sanctions and NATO alliance military action. Using American or European controlled reinsurers in crucial roles financing China's catastrophe and agriculture protection endangers China's national security.

China has used European controlled insurers and reinsurers that have huge exposures to European sovereign debt and 31.5% of the global reinsurance market with resulting concentrations of risk that threaten their solvency. The International Association of Insurance Supervisors and Financial Stability Board have named major European and American insurance and reinsurers as systemic risks threatening the collapse of the global financial system.

American and European brokerage firms control 80% of the international reinsurance markets. The European and American reinsurers that control over 60% of the international reinsurance markets want to dominate China's insurance and reinsurance markets. Their growth strategies of taking market share from Chinese companies hinder China's companies' development domestically and internationally. Their goals do not align with China's needs. Foreign companies have 4% of China's insurance and 1% of its reinsurance markets.

Bermuda reinsurers do not have ambitions to dominate China's domestic market and compete very successfully with American and European reinsurers. They are the world's second largest reinsurance market and provide over 50% of the existing global catastrophe reinsurance protection.

China can Recirculate some SAFE Foreign Currency Reserves in Good Investments

SAFE and China Investment Corporation should invest in financing China's reinsurance for agriculture losses and catastrophe losses because China is the only reliable source of the massive, stable, long-term additional capital required to finance China's risks in the international reinsurance, capital and commodity markets.

Without China's stabilizing new roles, the reinsurance and capital markets do not have the scientific management capabilities required. They are dominated by chaotic, irrational "animal spirits" that caused the global financial crisis triggered in America and Europe.

Once China's new catastrophe and agricultural loss financing products "smoothing" loss costs are working well, such financing products can be scaled internationally. Many nations need agriculture and catastrophe insurance and reinsurance coverage. China is the only entity in the world with the credible liquid assets to pay peak catastrophe and agriculture insurance and reinsurance products.

As China's economy becomes the world's largest, China needs to add the capital required for the stable functioning of the international reinsurance, retrocession and ILS markets. Nations that lack catastrophe and agriculture insurance and reinsurance are essential trading partners that China's economic stability and national security depend on. The United Nation estimates that 60% of the economic losses caused by natural catastrophes are not insured. China can take a leading role with other nations' sovereign wealth funds, pension funds and long-term investors providing the stable financing required to smooth the economic impact of mega catastrophes, which all nations require. When China becomes the largest consumer, provider and investor in catastrophe and agriculture insurance, reinsurance and insurance linked securities, then China and Bermuda companies as strategic partners can become the reliable catastrophe and agricultural reinsurers that China, its trading partners and the world need.

Sidebar

John & Dai Min Milligan-Whyte

John Milligan-Whyte, author of Whyte Daimin Reinsurance Finance Center's Plan for Shanghai's Free Trade Zone and China Catastrophe and Agriculture Insurance System Plan, was Chairman of the Committee Advising Bermuda's Minister of Finance on Reinsurance, member of Bermuda's Law Reform Commission and United States National Association of Insurance Commissioners Advisory Committee drafting the US Model Insurance Act, Vice Chairman of the American Bar Association's Insurance Section. He is a director of Whyte Daimin Investments Limited and was a director of insurance, reinsurance and hedge fund companies, co-recipient of the 2002 Asian M& A Deal of the Year Award, and recipient of the China Business Leaders Summit's Outstanding Business Leader's Social Responsibility Award.

Dai Min, a Research Professor and President of the Whyte Dai Min Reinsurance Finance Center, initiated the China Insurance Industry Leadership Program with Wharton, Renmin University and XL Group Plc approved by the China Insurance Regulatory Commission and was a currency trader on Wall Street and advised foreign and Chinese companies since 1990.