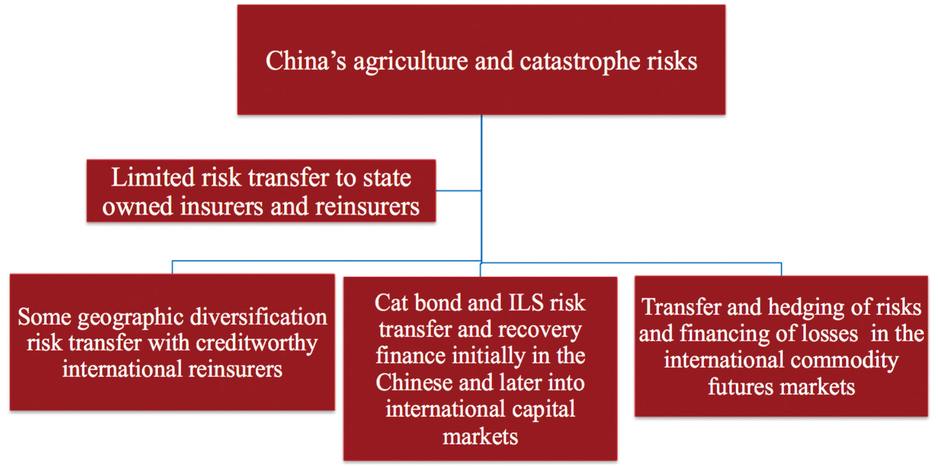
Whyte Daimin Framework and Products for China's Catastrophe Coverage

WHYTE DAIMIN CATASTROPHE RECOVERY FINANCE CENTER

This article introduces key features of the Whyte Daimin Catastrophe and Agriculture Risk Transfer and Loss Funding Framework and Products for China's catastrophe and agriculture risks.



The China Insurance Regulatory Commission (CIRC) and the Insurance Institute of China (IIC) are implementing high priority mandates from China's State Council in insurance pilot projects that seek scalable ways to transfer risks and commercially finance losses. The goals are to transfer 15% or more of China's government subsidized catastrophe and agricultural losses and better protect China's 1.5 billion residents. Catastrophe losses China's national, provincial and local governments fund are at least US$ 45 to $70 billion a year and in high loss years will be far higher and 99% of catastrophe and more than 55% of agriculture economic losses are uninsured and borne by Chinese citizens and companies.

CIRC's insurance pilot projects seek to provide coverage: in Shenzhen for catastrophe caused death, personal injury and medical costs, in Yunnan, Sichuan and Gansu for earthquake property damage, in Tianjin for earthquake index insurance, in Guangdong for serious illness, in Ningbo for typhoons, floods, other natural disasters and agriculture losses, in Shanghai for agriculture risks and the establishment of an internet insurance exchange.

The urgency and challenges in finding solutions that are successful locally and scalable nationally is evident in the first pilot project in Shenzhen. CIRC approved its inception in June 2014 with the publicly stated goal of providing coverage for death, disability and medical payments of up to US$ 15,000 per person covering 10 million people in the event of all types of catastrophes. This would require US$ 150 billion in geographically concentrated coverage per year and is far beyond the capability of international reinsurers' assets of US$ 578 billion and catastrophe bond investors' capital of US$ 78 billion in 2014. PICC fronted and transferred 99.99% of its risk to Swiss Re, which provided US$ 400 million of coverage for payments of US$ 6 million using its Vita Capital cat bond funds. This response, which was discontinued in June 2015, was not large enough, nor scalable in Shenzhen or nationally. CIRC's plan is to spread catastrophe risk among 47 Chinese insurers and a catastrophe fund. This also is not scalable in Shenzhen or nationally. A Chinese company using the existing approach in the cat bond markets, which are not adequate to meet the volume of China's needs, will issue China's first experimental catastrophe bond for US$ 20 million in 2015 using a special purpose vehicle in the regulatory framework in Bermuda. These mechanisms do not fulfill the increased commercial risk transfer and loss financing system China is developing.

To assist in designing and implementing scalable solutions Whyte Daimin Catastrophe Recovery Finance Center in Bermuda and Beijing delivered a Research Report and Recommendations summarized in the chart above, introduced in eleven articles in the Ministries of Commerce and Finance publications, *China International Business Magazine* and *China State Finance Magazine*, accessible at *www.whytedaimininvestments.com*, and in a supporting textbook, *China's Potential Roles In A Sustainable Scientifically Managed Global Catastrophe Recovery Finance System* being published in Mandarin in 2015. Whyte Daimin Investments Limited, its Catastrophe Recovery Finance Center and other experts are developing (1) a new genre of Simplified Commoditized Catastrophe Bonds initially available to investors that are Chinese citizens and companies and later to all investors that will provide a better, cheaper, transparent solution that can be scaled nationally and internationally, (2) new products enabling China's catastrophe and agricultural risks to be transferred, tradable and hedge able by all investors on the CME Group's weather, agriculture and other commodity exchanges, and (3) the business plan for Asian Catastrophe Recovery Finance Limited, a company using the new framework and products, designed to assist the Asian Infrastructure Investment Bank to meet the need for US$ 42 Trillion in infrastructure finance requiring natural catastrophe risk protection.

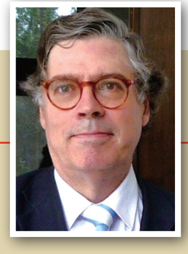
A key problem in creating a sustainable catastrophe and agriculture risk transfer system for China and globally able to attract the huge capital required is that reinsurers and development banks currently provide the only products for catastrophe and agriculture risk transfer and recovery finance. They promote governments subsidizing both the lower layers of coverage and peak catastrophe layers too large and dangerous for reinsurers to cover. Reinsurers do not have the capital to fund China's catastrophe risk transfers domestically or globally. Consumers and businesses worldwide often find existing forms of catastrophe insurance and reinsurance unavailable at all, or too expensive to buy, too limited in coverage and too slow in paying claims. The existing forms of catastrophe bonds are too complex and convoluted to meet existing investor demand and are not scalable to adequately meet China and other nations' huge risk transfer and loss financing needs. The coverage is limited and unreliable in existing World Bank supported partnerships between reinsurers and governments using catastrophe pools with coverage provided by reinsurers and catastrophe bond investors. Major losses were not covered, for example, in the Mexico and the Pacific Islands pooling schemes when catastrophes actually occurred.

The traditional framework and products for catastrophe risk transfer will not work reliably and affordably in lower per capita income nations. Thailand is an instructive case study. The World Bank's estimate of the 2011 Thailand flood economic losses was US$ 45.7 billion. According to A.M. Bests, the insured total loss estimates made by 15 reinsurers ranged from US$ 8 billion to US$ 23 billion. Thailand's Deputy Prime Minister proposed the creation of a new reinsurer for the Asia region because the three largest global reinsurers would either not deal with Thailand or demanded greatly increased premiums. Manufactures had to stop production during the floods and threatened to leave Thailand. The government assured them it was implementing mitigation investments and recovery strategies. It established a National Catastrophe Fund with US$1.6 billion of government capital and guarantees, which provided a million catastrophe insurance policies covering flood, windstorm and earthquakes. Thailand will have other major loss years. This is not a sustainable solution.

The new Catastrophe Risk Transfer and Recovery Finance Framework and Products provide the paradigm change essential to fulfill China's needs for reasons detailed in the earlier articles in this series. In addition, in 2014 the United States threatened to impose sanctions on China and military intervention, which would be an act of war, if China uses "coercion or force" in South China Sea territorial disputes. Conflict may be triggered by other nations and can lead to the result that international reinsurers will be unable to pay China's catastrophe and agriculture claims. It was concern over the impact of US and EU sanctions against Iran that led India to propose the creation of a new BRICS reinsurance company as a corollary to the BRICS bank set up in 2014 based in Shanghai.

The reinsurance industry is working diligently with the United Nations, World Economic Forum, International Insurance Society and Willis Research Network to provide innovative coverage in low per capita income nations. The Blue Marble Microinsurance initiative presented at the 2015 Global Insurance Summit is a promising example. The new Catastrophe Risk Transfer and Recovery Finance Framework and Products will help to profitably and affordably provide the massive financing support using innovations and capital from China that are essential for the deployment of such innovative catastrophe loss funding projects globally.

Sidebar



John Milligan-Whyte, Chairman of the Whyte Daimin Catastrophe Recovery Finance Center, advises CIRC, IIC and was Chairman of the Committee advising Bermuda's Minister of Finance on Reinsurance and Insolvency, member of Bermuda's Law Reform Commission and the United States National Association of Insurance Commissioners' Advisory Committee Drafting the US Model Insurance Act and Vice Chairman of the American Bar Association's Tort & Insurance Section. He is Chairman of Whyte Daimin Investments Limited and was the legal advisor and director of insurance, reinsurance and hedge fund companies, and was a founding partner in a Bermuda law firm that was a World Economic Forum member and co-recipient of the Financial Law Review's 2002 Asian M&A Deal of the Year Award. He was elected the recipient with 12,534 votes of the China Business Leaders Summit's Outstanding Business Leaders' Social Responsibility Award in 2009.

Dai Min, a Research Professor and President of the Whyte Daimin Catastrophe Recovery Finance Center, was a currency trader on Wall Street and has advised Chinese and foreign companies since 1990, and in 2005 initiated the China Insurance Industry Leadership Program at Wharton and Renmin Universities funded by XL Group Plc and approved by the China Insurance Regulatory Commission.