Jacqueline Loh: Unlocking insurance linked securities growth through Asia

Opening speech by Ms Jacqueline Loh, Deputy Managing Director of the Monetary Authority of Singapore, at the Artemis ILS Asia 2018 Conference, Singapore, 12 July 2018.

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Distinguished guests, ladies and gentlemen, a very good morning to all of you.

2 I am very pleased to be here today at the Artemis ILS Asia 2018 conference. The third time that it is held in Singapore, the conference is a good market barometer that Insurance-linked securities (ILS) are becoming more prominent in Asia, and prospects are bright for the coming years.

Alternative Capital becomes Mainstream

3 We are gathering here at an exciting time for the global Insurance-linked securities industry, with alternative capital being an increasingly important part of an insurer's risk transfer toolkit. Born from a need to bring additional loss absorbing capacity following the devastating disasters in the mid-1990s – Hurricane Andrew and the Northridge earthquake in California – the development of the ILS market has been a remarkable story of innovation.

4 Twenty years later, the global ILS market continues to thrive. Emerging from the HIM (Harvey, Irma and Maria) hurricane losses, earthquakes in Mexico and wildfires in California, 2017 has been widely billed as the Global Financial Crisis equivalent for the ILS market, as it registered the largest losses in more than a decade. Yet, the ILS market has remained largely resilient. Growth remains strong in 2018, with issuance of catastrophe bonds the most prevalent type of ILS, more than doubling compared to the same period last year. ILS rates have stabilised after having risen post these disasters, and subsequently dipping with the influx of capital. Catastrophe bond managers have continued to launch new ILS funds in response to strong demand from investors. Today, the ILS market has grown to the point where it now provides 15% of global catastrophe reinsurance capacity.

5 Let me highlight 2 key reasons why ILS has been growing over the years:

a. First, it offers sponsors a viable alternative to enhance risk transfer programs. ILS provides diversification of the source of risk capital, multi-year coverage, and also competitive rates compared to traditional reinsurance.

b. Second, there is strong demand from investors given ILS' low correlation with other asset classes, and low volatility. To illustrate, the Swiss Re Global Cat Bond Index has an annual volatility under 3%[1], much below the 15% and 5% for equities and corporate bonds respectively. In addition, catastrophe bonds also offer ILS investors a liquid investment option as they can be traded on the secondary markets.

6 The ILS market has continued to innovate in response to the growing and changing needs of sponsors and investors. This innovation is happening along different dimensions, namely in risk types, geography, and structures.

a. On risk types and geography.

i. ILS has now expanded its scope to cover other lines of business like operational risks and mortgage risks. Once the preserve of large and complex risks such as property catastrophe and mortality risks with a long history of well modelled losses, it is now considered for lines previously deemed uninsurable, such as cyber.

ii. Second, the catastrophe ILS market is no longer dominated by wind exposure in the United States, and spreads over perils like earthquakes and floods in other regions such as Japan, Europe and recently Latin America.

b. On ILS structures, the market is moving beyond ILS bonds and increasingly issuing collaterised reinsurance, sidecars, an d industry loss warranties.

Asia is the next frontier for ILS growth

7 As ILS funds continue to seek diversification opportunities for their investment portfolios, Asia is poised to be the next frontier for ILS growth. At first glance, the economics of ILS in Asia appear to be challenging. Asia is still a developing market with low insurance penetration. Traditional reinsurance coverage is still competitive in the region. Apart from more mature markets such as Japan and Australia, a large part of Asia has yet to tap the capital markets for their growing insurance needs.

8 Yet, it is likely that ILS will achieve a breakthrough in the coming years, as the protection gap in Asia widens. Over the last 20 years, Asia has accounted for almost half of the world's economic losses from natural disasters, amounting to more than US$900 billion. Economic losses in Asia Pacific is projected to exceed US$160 billion annually by 2030[2]. The protection gap in Asia is set to widen for the following three reasons:

a. First, the frequency and severity of natural catastrophes is increasing. According to UN data, the number of natural disasters in the Asia-Pacific has increased from an annual average of 44 disasters in the 1970s to 146 in the 2000s.

b. Second, the wealth and value of assets at risk have also increased. Strong economic growth in Asia and growing urbanisation has led to the rise of small highly-populated megacities, many of which lie along areas that are exposed to natural perils.

c. Third, insurance penetration is still low in Asia. Just over 8%[3] of natural catastrophe losses are insured in Asia as compared to 40% in developed regions.

9 ILS, together with other risk management solutions including reinsurance and government pools, have significant scope to play a larger role in reducing the financial impact of natural disasters. Globally, UK, Spain and France have already established natural catastrophe schemes that tap on a combination of traditional and alternative capital.

10 There are positive signs of change, with ASEAN making a push to address its rising exposures to natural catastrophe. Let me provide some examples of recent developments:

a. ASEAN has commenced a holistic approach to disaster risk management through the ASEAN Disaster Risk Financing and Insurance (ADRFI) Programme. The Programme will strengthen ASEAN's disaster risk management capabilities through:

i. Improving data required for assessing disaster risk exposure and financing solutions.

ii. Enhancing knowledge on disaster financing solutions through capacity building.

iii. Harnessing risk advisory expertise to provide advice and design risk financing solutions. These building blocks will enable ASEAN members to better understand their needs and design appropriate disaster risk financing programs including through transferring risk to capital markets.

b. Governments are increasingly using alternative risk transfer mechanisms such as government pools, like the Philippines parametric disaster insurance pilot, the Thai crop insurance scheme and the Vietnam pilot agriculture programme. In May this year, the establishment of the Southeast Asia Disaster Risk Insurance Facility (SEADRIF) in Singapore was officially announced. As ASEAN's first regional catastrophe risk facility, SEADRIF will start by establishing a regional catastrophe pool to insure the flood risks of Lao and Myanmar. SEADRIF will also seek to sponsor different risk management strategies, including issuance of catastrophe bonds, or to act as a reinsurer to national catastrophe pools, to further strengthen the region's financial resilience to disaster risks.

Supporting ILS growth in Asia through Singapore

11 The presence of a full-fledged ILS market and ecosystem in the region will encourage the development of this risk financing instrument. However, there is currently no established market in Asia for ILS.

12 As the leading financial centre in Asia, Singapore is well positioned to fill this need:

a. We are a well-established regional insurance hub that offers a comprehensive spectrum of re/insurance activities through a vibrant ecosystem of re/insurance players and service providers. There is also a strong catastrophe risk ecosystem to support ILS issuances, with the leading catastrophe modelling firms with ILS expertise present in Singapore, and research institutes such as the Earth Observatory of Singapore and the Institute of Catastrophe Risk Management, to support data and modelling needs. Singapore also aims to serve as the Asian knowledge centre for new and emerging risks.

b. Singapore is well recognised as a premier asset management centre in Asia, with deep capabilities across both traditional and alternative asset classes. As the gateway to alternative capital providers such as pension funds, family offices, and hedge funds in Asia, ILS fund managers are increasingly assessing Asian investors through Singapore.

c. Singapore has a deep debt capital market, with a broad range of bond offerings to provide collateral for and to support innovative ILS products and structures. SGX, a dynamic stock exchange, can facilitate bond trading.

13 Second, Singapore has ready corporate, regulatory and tax frameworks to facilitate ILS issuances:

a. ILS instruments can be issued and regulated in Singapore via the Special Purpose Reinsurance Vehicle ("SPRV") regulations, which allows sponsors to readily securitise insurance risks in Singapore.

b. To provide tax neutrality for ILS vehicles, Singapore offers the Approved Special Purpose Vehicle ("ASPV") scheme.

14 Third, MAS has taken steps nurture the growth of the ILS market in the region.

a. MAS launched the ILS grant scheme in Jan this year, which will fund 100% upfront issuance costs of catastrophe bonds in Singapore, up to S$2 million. The aim of the scheme is to defray the frictional costs of catastrophe bonds issuances.
We have received keen interest from the region, with a healthy pipeline of issuers keen to tap on the grant scheme to issue a catastrophe bond here. Leading insurance brokers have expressed support for Singapore as a domicile and are working with their Asian clients for potential issuances here.

b. We have also formed an industry-led Alternative Risk Transfer work-group to advise MAS on initiatives to support the development of Singapore as an ILS domicile. The workgroup will continue to provide feedback on the current ILS regime including on regulations, tax and structures.

15 Fourth, our proximity to Asian markets allows for a deep understanding of underlying risks and needs of the sponsors. We have grown as a traditional re/insurance market due to this and it will likewise be an important consideration for Asian ILS issuers looking to tap capital markets in the region, and for capital providers that are underwriting the risks.

16 Despite this promising outlook, we recognise that ILS expertise is still nascent in Asia, and there is much scope for Singapore to learn from international best practices. We hope to strengthen Singapore's proposition as a ILS domicile in 4 ways:

a. First, we seek to explore the introduction of bespoke corporate structures for the ILS market, like the Protected Cell Company (PCC) structure, to provide more structuring options to potential issuers. A PCC structure would facilitate multiple issuances in one vehicle with its segregation of assets and liabilities, and is sometimes preferred by issuers for its efficiency in cost and operations.

b. Second, we understand speed to market is a crucial factor for issuers as it provides certainty for their reinsurance structure. We will work closely with issuers to explore the potential of further streamlining the licensing requirements and process in Singapore.

c. Third, we recognise that structuring ILS requires specialised roles beyond the conventional pool of debt capital market teams, such as loss reserve specialists and capital market advisory teams. MAS will explore support for the setting up of specialist teams in Singapore, to facilitate knowledge transfer to the local market. To raise the industry's skills in this area, there are plans to incorporate catastrophe modelling for catastrophe bonds in existing training programs.

d. Fourth, the need for quality data. Data is key for catastrophe risk quantification and the design of risk transfer tools like ILS. We know that there is room to improve data quality in this region and have embarked on the Natural Catastrophe Data Analytics Exchange since April 2017 to bridge the data gap. High resolution data, obtained through innovative technology and new methodologies, can complement other traditional sources of industry data, and support the underwriting of traditional insurance products and structuring of ILS.

Conclusion

17 Asia holds promise for the next phase of growth for ILS given the region's growing needs, and Singapore can play an important role to facilitate this growth as an ILS domicile. Today's conference will provide an important platform for the industry to discuss such developments in the ILS market, and explore the key to harnessing the potential in Asia.

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1 Schroders: Spotlight on catastrophe bonds

2 Disasters could cost Asia-Pacific region $160 billion per year by 2030, UN warns, UNESCAP, 2018

3 High CAT risks, low penetration in Asia – only two ways out, AIR, 2017