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**DRAFT CONCEPT PAPER**

**PROPOSAL FOR AN ENERGY-FOCUSED CAPTIVE INSURANCE MULTI-WINDOW FACILITY FOR SMALL ISLAND DEVELOPING STATES (SIDS):**

**ADAPTING TO CLIMATE CHANGE BY CREATING AFFORDABLE INSURANCE-RELATED SOLUTIONS**

**Executive Summary**

There now exists more reasonable grounds to fear that projections of more frequent, ferocious and intense hydro-metrological events like never seen before in humanity will impact Small Island Developing States (SIDS), first, and the worst. Paying for the massive damages is now a major preoccupation of the SIDS Leadership, who grappled with unprecedented losses in 2017, due to exceptional weather-related events that caused devastation and destruction right across the SIDS in the Caribbean, Pacific and Indian Ocean regions. Forecasters expect a slightly above-average 2018 Atlantic and Central Pacific hurricane season and nervous and worried local authorities across the SIDS are already warning citizens to prepare ahead of time.

The multi-billion-dollar losses suffered as a result of the devastating 2017 Hurricane and Cyclone season once again highlighted the inadequate and/or lack of catastrophe insurance coverage in several Small Island Developing States. Estimates from the Association of Trinidad and Tobago Insurance Companies (ATTIC)[[1]](#footnote-1) are that damages from the hurricanes in the Caribbean are in excess of USD 50 billion; so far, initial regional feedback suggests a high percent of policyholders’ property and valuable assets in islands devastated by hurricanes were “uninsured or underinsured”.

In the case of the Caribbean, the eleven-year-old Caribbean Catastrophic Risk Insurance Facility (CCRIF) paid out USD 55 million to nine (9) member governments after the 2017 Hurricanes Maria and Irma. The CCRIF has been providing parametric catastrophe insurance coverage since 2007 for hurricanes and earthquakes and since 2013, for excess rainfall in the Caribbean extending into Central America in 2015. Pay-outs up to December 2017 have amounted to approximately USD 130.5 million,[[2]](#footnote-2). Within this context, the facility is exploring scaling up to better serve the countries in the region.

The CCRIF was formed in the aftermath of Hurricane Ivan in 2004, which caused billions of dollars of losses across the Caribbean. In Grenada and the Cayman Islands, losses were close to 200 percent of the national annual gross domestic product (GDP). But much more than the CCRIF is needed at this time. Collectively, SIDS have the opportunity to develop their own mechanism aimed at managing and transferring risks associated with climate change.

When the SIDS Leadership decided to create SIDS DOCK in 2009, it was with the realization that small islands would have to seek ways in which to finance adaptation as the promised level of support was not forthcoming. It was truly innovative on the part of the SIDS Leadership to develop the idea that financing adaptation was possible through the transformation of the SIDS energy sector to achieve low carbon economies. Similarly, the annual debate at the United Nations Framework Convention on Climate Change (UNFCCC) Conference of Parties (COP) meetings on Loss and Damages is equally long-suffering, extending back to the same time period when SIDS DOCK was formed. In this instance, the SIDS Leadership are now exploring SIDS-centred innovative financial tools in climate change risk management, and ownership, by SIDS, is at the heart of the proposed new mechanism.

SIDS DOCK, working with insurance and finance professionals and development partners, has identified two synergistic programmes that could potentially reduce insurance premiums by up to fifteen percent (15%), stimulate the use of sustainable energy and building through insurance credits, decrease the outflow of premium dollars to foreign countries, and increase the affordability of insurance for homeowners. These innovative financial mechanisms have the potential to provide a meaningful risk-transfer option for small islands.

The mechanisms described include both insurance mechanisms and other forms of risk spreading and sharing, referred to as non-insurance mechanisms. SIDS need a comprehensive solution that does not propose implementation of a particular financial instrument exclusively, as what pertains. SIDS need a mechanism that has a multi-window orientation in the way of mitigation strategies, prevention and adaptation, as well as the use of risk transfer instruments such as insurance, at different scales, i.e., for individuals or small communities or pools of countries, and governments; a model than can also provide cover for slow-onset events such as sea-level rise. Finally, it should also differentiate among frequent events and disasters of lower probability.

Two programmes are proposed with collective action and SIDS-ownership as the mutually defining characteristic:

1. Owner Controlled Insurance Programme (OCIP)
2. Captive Insurance Facility (CIF)

***Owner Controlled Insurance Programme (OCIP)***

Anecdotal references and a scoping exercise indicated that behind a number of contracts related to infrastructure works, SIDS pay enormous sums in hidden fees, bank charges, administrative overheads and various transactional charges that grossly inflate bid packages. The insurance cost component of a typical construction project is normally between 2-4 percent of hard construction costs. As an example, a $100 million project will include insurance costs of between $1.4 million and $2.8 million. By requiring that contractors exclude insurance from their bids and, instead, insuring each project, or, group of projects with project-specific insurance, SIDS can reduce insurance costs by as much as 15 percent. The procurement mechanism used for accomplishing this is known as an Owner Controlled Insurance Programme (“OCIP”). An OCIP is an insurance programme­ effected by the sponsoring organization (SIDS DOCK) on behalf of all contractual participants which is normally structured to meet the key asset, legal liability and financial risks associated with a Sponsor’s construction projects.

OCIPs have tremendous advantages for SIDS, in that all insurance costs are collected into a single policy premium, rather than embedded inside the bids of dozens of contractors and sub-contractors to cover multiple projects. In addition to lowering premiums, the purchase of liability insurance on a project-specific basis, through an OCIP, will give SIDS and their insurance advisors advantages in negotiating insurance policy terms and conditions.

***Captive Insurance Facility (CIF)***

SIDS need a strategy based on several financial instruments, all of them supported by a cornerstone in the way of a trust fund that facilitates the development of a captive insurance entity. A captive is an ideal financial vehicle to transfer, transparently, risk to the global reinsurance and capital markets and an equally ideal solution for specific risks and complexities as those risks that uniquely characterizes small islands. Captive Insurance structures, a form of self -insurance, can be a favourable alternative to traditional commercial insurance markets. Captive entities can benefit from profit from their investment from insurance activities and any underwriting profit after losses and expenses. Unlike traditional risk transfer to a commercial market counter-party, if there are any excess funds left after payment of all liabilities, a profitable Captive Insurance Company can become a catalyst for generating financial resources for sustainable economic development.

A captive provides opportunities to more easily structure insurance programmes since the captive is not subject to the same constraints and conventions normally evident with traditional insurers. The group captive insurance premium is typically lower, often substantially, than the cost of traditional insurance. This is because the premiums are based on actual loss experience and projected losses rather than the general rating scale of a traditional insurer. Also, the commercial insurance market has high administrative costs which are passed on to their clients within the premiums charged. A captive can reduce the overall cost of an insurance programme by retaining the premium for the expected losses, thereby avoiding the premium loading for a commercial insurer’s overheads and profits.

Like all programmes, both the OCIP and the CIF have potential constraints, including meeting capital commitments, risk of adverse results, operating costs and the amount of expenses and fees, but both would still give SIDS an option under their control that they can collectively reduce costs, insure difficult risks, gain direct access to reinsurance markets, and increase cash flow for economic development, or, other priorities in the SIDS such as building resilience to climate change. Based on the decision at the 3rd Meeting of the SIDS DOCK Assembly, held September 23, 2017 in New York, at the United Nations, and the work by the SIDS DOCK Secretariat and members of the Executive Council, SIDS should consider hiring a professional consulting firm to perform a feasibility study to determine whether a SIDS owner-controlled insurance programme and captive insurance facility is feasible for the organisation. This financial and risk management analysis should provide the justification for transferring retained risk to a captive, rather than financing risk using commercial insurance or a self-financing programme. If the legitimacy or wisdom of the risk financing programme is subsequently challenged, a well-written feasibility study can be invaluable in defending the captive programme.

**1.0 climate change – THE CLEAR AND PRESENT DANGER: THE URGENT NEED FOR insurance-RELATED solutions FOR SMALL ISLANDS**

*“Over nine countries of the region have been impacted by three hurricanes including Dominica, Antigua, the Bahamas, British Virgin Islands, Sint Maarten, Puerto Rico, and others. Damages in the region estimated are over $10 billion.  The 100-year storm, colleagues, is now the new norm.  We are entering into a new and unprecedented era of climate change and its grievous effects upon us all”.* Dr. The Rt. Hon. Keith Mitchell, Prime Minister of Grenada, Chairman of CARICOM, October 13, 2017[[3]](#footnote-3)

The people of the Caribbean experienced two Category 5 storms in just over two weeks. The devastating 2017 hurricane season can provide the Caribbean Community (CARICOM) with an opportunity to review its adaptation strategy in terms of exploring innovative and affordable insurance-related solutions in order to achieve its stated ambition of making the Caribbean the first climate-resilient zone in the world. For small islands, building climate resilience is much more than the ability to become less vulnerable and more about the capability to respond and recover. The ability to respond and recover is linked to national capacity which determines the ability to extract and efficiently utilize energy, food and water from the natural resource base.

Climate change is a clear and present danger to Small Island Developing States (SIDS) and Low-Lying Developing States. Even the oil companies, like Exxon and Shell, have now publicly accepted the science of climate change and the need for international action to address the issue. There now exists more reasonable grounds to fear that projections of more frequent, ferocious and intense hydro-metrological events like never seen before in humanity will impact SIDS, first, and the worst. With the ever-expanding access to the global communication highway and the Internet, people across the world were able to see and hear about the non-stop, multi-billion-dollar hydro-metrological assault on the small islands of Dominica, Antigua, Tonga, Mauritius, Seychelles, and Fiji, from September 2017 to March 2018.

The result: a giant step backwards to a primitive life highlighted by loss of lives – we know that women and children are 14 times more likely to die from a disaster, and we know that women and girls are more likely to suffer sexual and gender-based violence in post disaster situations, and with each event the numbers increase; homelessness and displacement, broken lives and broken infrastructure, lack of or reduced social services, virtual standstill and slow recovery of the all-important tourism sector, and threats to national security due to dislocation of the security forces. Climate-related disasters represent a major source of risk for the poor in developing countries, and the losses caused are seen as a major threat to the achievement of the United Nations (UN) Sustainable Development Goals (SDGs) and Caribbean countries’ efforts to fulfil ambitions under their Nationally Determined Commitments (NDCs), which are at the heart of the 2015 Paris Agreement. Immediate adaptation action is required, as the economic costs of climate-related disasters are high and continuing to rise.

There were 330 natural catastrophe events in 2017, that generated economic losses of USD 353 billion, of which 97 percent (USD 344 billion) was due to weather-related events, including Hurricanes Harvey, Irma and Maria in the United States (US) and the Caribbean, plus Typhoon Hato in China and Cyclone Debbie in Australia. The United States made up about 50 percent of global insured losses in 2017, compared with just over 30 percent on average. For historical context, 2017’s natural catastrophe losses were 93 percent higher versus the 2000-2016 average, making 2017 the costliest year on record for weather disasters. It was also an expensive year for the insurance industry, the reinsurance market had an estimated USD 600 billion in available capital to withstand the high volume of payouts; 2017 was also the third warmest year on record since 1880, for combined land and ocean temperatures[[4]](#footnote-4).

Costs totaled USD 1 trillion worldwide from 1980 through 2003, compared to USD 154 billion in 2015. The estimates of natural disaster economic damages place 2015 as the fifth costliest since 2006, 12 percent above the 2006-2015 annual average. Insured losses to the private sector and government-sponsored programmes were among the costliest ever incurred, reaching USD 134 billion in 2017 – just behind the record USD 137 billion in 2011. This is 139 percent higher than the USD 56 billion in 2016, primarily due to high insurance penetration in the US that suffered a very active Atlantic hurricane season, severe weather events (convective storms) and wildfires[[5]](#footnote-5).

In the case of the Caribbean, the eleven-year-old Caribbean Catastrophic Risk Insurance Facility (CCRIF) paid out USD 55 million to nine (9) member governments after the 2017 Hurricanes Maria and Irma. The CCRIF has been providing parametric catastrophe insurance coverage since 2007 for hurricanes and earthquakes and since 2013, for excess rainfall in the Caribbean extending into Central America in 2015. Payouts up to December 2017 have amounted to approximately USD 130.5 million,[[6]](#footnote-6). Within this context, the facility is exploring scaling up to better serve the countries in the region. The CCRIF was formed in the aftermath of Hurricane Ivan in 2004, which caused billions of dollars of losses across the Caribbean. In Grenada and the Cayman Islands, losses were close to 200 percent of the national annual gross domestic product (GDP).

**2.0 THE NEED: ADAPTING TO CLIMATE CHANGE BY CREATING AFFORDABLE INSURANCE-RELATED SOLUTIONS**

Governments in the Caribbean advocated for the establishment of the CCRIF - the world’s first regional risk-pooling fund issuing parametric insurance - launched in 2007, the same year the Intergovernmental Panel on Climate Change (IPCC) issued a devastating report that included the projected negative impacts facing SIDS. At the same time, the UN Framework Convention on Climate Change (UNFCCC) Secretariat also released a new report from a 2007 SIDS regional meeting which spelled out further actions that can facilitate adaptation to climate change for such countries. The report noted that SIDS are a good example of countries where insurance rates continue to increase from year to year. But in these countries, insurance-related action on the part of governments also provides a unique opportunity to provide incentives for risk reduction, as a tool for adaptation, while at the same time engaging the private sector in climate change response action[[7]](#footnote-7). The CCRIF provides an important mechanism for Caribbean countries; 2017 payouts were all settled within 14 days of the hazard event and have been critical for immediate response and recovery activities following these devastating events.

The CCRIF is also looking to scaling up, as it is believed that it could include providing increased CCRIF coverage for existing members, adding new members to CCRIF – in both the Caribbean and Central America and maybe even beyond, and introducing new products such as a drought product as well as providing coverage for the agriculture and fisheries sectors and public utilities (e.g. water and wastewater; energy, including renewables; and telecommunications) and possibly other economic industries such as tourism. CCRIF in collaboration with the Munich Climate Insurance Initiative will be focusing on increasing the number of low-income persons in the region who have access to climate risk insurance through a micro insurance product known as the livelihood protection policy (LPP) and increase the number of companies in the region offering this micro insurance to the most vulnerable in our societies.

But much more is needed. Risk management techniques, particularly from a financial perspective, have become an important tool for analysis and design of adaptation proposals. Currently, within the international scientific community there is discussion about the accurate size of losses, while at the Government level there are calls for implementing adaptation actions now, that are of a win-win nature. Nevertheless, a common point among several scenarios of losses is that all of them imply large amounts of losses for the global economy. Hence, many experts have started to apply financial technology, currently successfully applied to the financial industry, to propose solutions for climate change risk management.

SIDS need a comprehensive solution that does not propose implementation of a particular financial instrument exclusively, as what pertains. In fact, SIDS need a strategy based on several financial instruments, all of them supported by a cornerstone in the way of a trust fund that facilitates the development of a captive insurance entity. SIDS need a mechanism that has a multi-window orientation in the way of mitigation strategies, prevention and adaptation, as well as the use of risk transfer instruments such as insurance, at different scales, i.e., for individuals or small communities or pools of countries, and governments; a model than can also provide cover for slow-onset events such as sea-level rise. Finally, it should also differentiate among frequent events and disasters of lower probability.

Due to the level of devastation in the CARICOM Member countries that had hurricane impacts during the 2017 season, there is not much detailed information available for Dominica and Antigua and Barbuda beyond the loss of life, extent of shelter destruction and estimated economic damages. Having stated that, information from US territories that experienced lower intensity impacts helps to show the challenges facing these islands. According to the New York Federal Reserve President William Dudley, the US territories of Puerto Rico and the Virgin Islands will need to take painful actions to restore their economies amid the hurricane devastation. In the storms, Puerto Rico suffered “by far” the most severe power outage in US history in terms of total customer hours lost.

The situation in CARICOM member countries is quite likely to be the same if not worst given the reality of Dominica, if they experience a similar event in the near future. Several Caribbean countries, notably Dominica, Antigua and Barbuda, the British Virgin Islands and Anguilla, were severely damaged when Hurricanes Irma and Maria made their way through the Lesser Antilles, as were Cuba, Puerto Rico, the Dominican Republic, US Virgin Islands, the Turks and Caicos Islands, Guadeloupe, the Bahamas, and St Martin. Estimates from the Association of Trinidad and Tobago Insurance Companies (ATTIC)[[8]](#footnote-8) are that damages from the hurricanes are in excess of USD 50 billion so far, initial regional feedback suggests a high percent of policyholders’ property and valuable assets in islands devastated by hurricanes were “underinsured”.

For CARICOM countries that suffered billions of dollars in damage, the CCRIF paid out USD 55 million in 2017. World Bank preliminary estimates indicated that Irma caused damages of about 14 percent of gross domestic product (GDP) for Antigua and Barbuda, for Dominica earlier estimates indicate that the total damage could reach 200 percent of GDP.  The whole population of Barbuda has been evacuated to Antigua.  In Dominica, housing, schools and hospitals have been severely damaged, if not completely destroyed, and 100 percent of agricultural land was uprooted[[9]](#footnote-9).

As suggested in the UN Framework Convention and the Kyoto Protocol, there has long been a realization that insurance solutions play an important role in adaptation to climate change. There is also the need to create financial risk-sharing and risk-management approaches and mechanisms that can help developing countries, especially LDCs, SIDS and countries in Africa, to reduce their vulnerability to the impacts of climate change. With that in mind, SIDS DOCK has been consulting with leading insurance experts, development partners and stakeholders to identify insurance-related strategies to climate-driven extreme weather events that will help achieve the following objectives:

* To create affordable insurance-related solutions that share responsibility to help manage the impacts of climate change, by combining the resources of the public and private sectors.
* To conduct and support pilot projects for the application of insurance-related solutions in partnerships and through existing organizations and programs. These activities focus on developing countries but at the same time involve evaluating insurance solutions.
* To promote insurance-related approaches in cooperation with other organizations and initiatives within existing frameworks such as the United Nations system, international financial institutions, international donors, and the private sector.

**3.0 OVERVIEW OF INSURANCE INDUSTRY-RELATED CHALLENGES FACING SIDS AND SOLUTIONS TO ADDRESSING THE CHALLENGES FROM A CHANGING CLIMATE**

The Caribbean is one of the most vulnerable regions in the world to natural disasters and in particular, to disasters caused by tropical cyclones; 15 Caribbean islands are in the top-25 positions of most tropical cyclone disasters per km2, and another 7, rank in the top-50. According to the International Monetary Fund (IMF), the total damages experienced in the Caribbean over the past 40 decades amount to USD 20 billion for the more than 200 major storms, which killed more than 12,000 people. About 1 percent of the Caribbean’s gross domestic product is wiped out every year[[10]](#footnote-10).

As extreme weather events such as droughts, floods, hurricanes and storms increase in frequency and intensity, they place significant stress on societies and natural systems. As a result, there is a growing need to explore meaningful options for managing and transferring risks associated with climate change. Braced with the understanding that extreme weather events and disaster losses are expected to increase in the future, the 32 SIDS DOCK countries must continue to explore strategies that can be undertaken collectively to reduce the catastrophic impact of disasters, enable a timely recovery and contribute to sustainable, climate resilient development.

Countries in the Caribbean recurrently use public debt to absorb the impact of external shocks and natural disasters. In turn, higher levels of public debt constrain capacity to effectively address vulnerabilities. As a result, each new wave of shocks and disasters simultaneously amplifies vulnerabilities and weakens domestic response capacity. For example, were Hurricane Gilbert (1988) to hit today, the cost to Jamaica would be around USD 1.3 billion, more funds than the Government holds for its budgeted disaster response[[11]](#footnote-11). In this regard, insurance provides reliable and timely financial relief for recovery of livelihoods and reconstruction, thus providing security in the post-disaster period. The CCRIF operates as a mutual insurance company for 16 countries in the Caribbean, whereby each country pays an annual premium directly related to the risks faced and, in return, receives insurance coverage of up to USD 100 million for each hazard, namely tropical storms, earthquakes and excess rainfall events[[12]](#footnote-12). Contextually, the largest payout ever made by CCRIF was USD 20 million to Haiti in 2016.

The Caribbean insurance market obtained its own identity in the 1970s, with the passage legislation governing the establishment of local insurance companies. Most companies then established had hitherto operated under general agency or branch structures of foreign (mainly UK) insurers. For the most part, these local operations continue today as insurance units of trading and financial companies whose profit strategies centre on their roles as agents for a wide range of products and services. Caribbean insurance companies have not been motivated to generate and expose significant capital for underwriting catastrophe perils. Furthermore, foreign insurers and reinsurers, with longer and broader expertise, remain willing to shoulder the major risk via reinsurance. Local insurance companies cede up to 80 percent of risks to foreign insurers and reinsurers. Consequently, the level of in-country investment by insurance companies is significantly less than in other locations where there is a much lower percentage of offshore reinsurance. In general, underwriters consider SIDS as high-risk and therefore assign a higher risk premium on investment financing.

The issue is complicated by low insurance penetration in the private market. Insurers say the penetration for non-life insurance is just 2.2 percent, and that the low coverage is due in part to 20 percent of the population living below the poverty line; reinsurer risk due to hurricanes; and limited alternative risk-transfer mechanisms. The damages resulting from the 2017 hurricane season, considered as the most active since the 2004 season according to ATTIC, are expected to “wipe out” more than 15 to 20 years of profits of reinsurers and insurers who do business within affected islands. Insurers who are still underwriting in the Caribbean have been issuing advisories to the regional insurance industry to plan significant rate increases during the upcoming reinsurance renewals.

According to ATTIC, one major reinsurer forecasted that insurance premium rates increases across the region from 20 percent to more than 200 percent. It was further noted that increases will not only be seen within islands affected by a windstorm event this season, but all islands. The anticipated increase in each island also being dependent on how underpriced the particular island’s premium rates are at this point in time. As noted in Table 1, total gross written premium (GWP) for SIDS Caribbean member countries is USD 4,796 million[[13]](#footnote-13).

***Table 1: Gross Written Premium (GWP) for SIDS Caribbean Member Countries (Year)***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Country** | **Currency** | **GWP (Local Currency, Million)** | **FX Rate(Local to USD), 3/23/2018** | **GWP (USD)** | **Market Size Ranking** |
| Antigua and Barbuda | XCD | $190.20 | 0.37037 | $70 | 151st |
| Barbados | BBD | $923.41 | 0.5 | $462 | 99th |
| Cuba | CUC | $556.30 | 1 | $556 | 93rd |
| Dominica | XCD | $63.06 | 0.37037 | $23 | 171st |
| Dominican Republic | DOP | $40,735.87 | 0.02008 | $818 | 79th |
| Grenada | XCD | $112.73 | 0.37037 | $42 | 160th |
| Haiti | HTG | $2,700.97 | 0.01527 | $41 | 159th |
| Jamaica | JMD | $77,530.20 | 0.00786 | $609 | 90th |
| Saint Kitts and Nevis | NA | NA | NA | NA | NA |
| Saint Lucia | XCD | $193.80 | 0.37037 | $72 | 150th |
| Saint Vincent and the Grenadines | XCD | $70.25 | 0.37037 | $26 | 167th |
| Trinidad and Tobago | TTD | $8,448.30 | 0.14748 | $1,246 | 70th |
| Lucayan Archipelago | NA | NA | NA | NA | NA |
| The Bahamas | USD | $795.54 | 1 | $796 | 83rd |
| Turks and Caicos Islands | USD | $34.53 | 1 | $35 | NA |

Based on initial regional feedback, a high percent of policyholders’ property and valuable assets in islands devastated by hurricanes were ‘underinsured’ and, therefore, will be subjected to ‘average’. The degree of underinsurance and the anticipated increases in premiums raised red flags for the countries prone to hurricane impacts across the region, as the likely scenario is that even more assets will be uninsured going forward under a *business as usual* scenario in the face of increasing hurricane intensity and damages. If insurers demand that property owners insure for full value, a significant number of property will likely join the trend of self-insurance and owners taking the risk as there is no other affordable risk sharing options. As expected, the cost on insurance for 2018 coverage in the Caribbean has been significantly increased, not so much due to the damages in the islands but rather on the mainland US.

**3.1 Solutions to Addressing the Challenges from a Changing Climate: A SIDS-Owner Controlled Insurance Programme**

As noted above, SIDS governments and businesses faced with billions of dollars in (re)construction costs because of the historic losses of 2017, will also be asked by construction contractors to pick-up the bill for their increasing insurance costs. Contractors pass on their respective insurance costs to their customers in their final bid packages. This method of accepting each contractor’s insurance fees is wasteful and costly. By accepting each contractor’s insurance (hidden) costs, SIDS is indirectly paying for the administrative overhead at dozens of separate insurance brokers and insurance companies. Contractors also frequently hide profit margin into the insurance cost portions of their bid packages. The insurance cost component of a typical construction project is normally between 2-4 percent of hard construction costs. As an example, a $100 million project will include insurance costs of between $1.4 million and $2.8 million.

**3.1.1 Owner Controlled Insurance Programme (“OCIP”)**

By requiring that contractors exclude insurance from their bids and, instead, insuring each project, or, group of projects with project-specific insurance, SIDS can reduce insurance costs by as much as 15 percent. The procurement mechanism used for accomplishing this is known as an Owner Controlled Insurance Programme (“OCIP”). An OCIP is an insurance programme­ effected by the sponsoring organization (SIDS DOCK) on behalf of all contractual participants which is normally structured to meet the key asset, legal liability and financial risks associated with a Sponsor’s construction projects.

***Financial Advantages:***

* **Establish a single rate structure -** SIDS will benefit from OCIP in that all insurance costs are collected into a single policy premium, rather than embedded inside the bids of dozens of contractors and sub-contractors to cover multiple projects.
* **Eliminate redundant premiums -** Eliminate gaps in or duplication of key insurances.
* **Remove the need to verify overlapping insurance arrangements** - Eliminate the need to check the scope and currency of most of the insurance arrangements of other project participants.
* **Provide coordinated claims process** - Provide a coordinated, claims reporting and handling facility which will not only ensure that the Employer has greater control over repair and reinstatement of damaged property but will also assist in the expeditious settlement of claims.
* **Reduce administrative costs** - SIDS will have direct control over administrative costs by dealing with a single broker and insurer.

Insuring infrastructure and other important construction projects in this manner will greatly heighten SIDS understanding of risk management and insurance principles and strategies and, importantly, improve SIDS leverage with insurance carriers. In addition to lowering premiums, the purchase of liability insurance on a project-specific basis, through an OCIP, will give SIDS and their insurance advisors advantages in negotiating insurance policy terms and conditions.

**3.1.2 Captive Insurance Facility**

Captive Insurance structures, a form of self -insurance, can be a favorable alternative to traditional commercial insurance markets. Captive entities can benefit from profit from their investment from insurance activities and any underwriting profit after losses and expenses. Unlike traditional risk transfer to a commercial market counter-party, if there are any excess funds left after payment of all liabilities, a profitable Captive Insurance Company can become a catalyst for generating financial resources for sustainable economic development. The major benefits that the establishment of a captive bring to its parent can be divided into two main categories: financial and insurance.

***Financial Advantages:***

**Reduced Insurance Costs** - The group captive insurance premium is typically lower, often substantially, than the cost of traditional insurance. This is because the premiums are based on actual loss experience and projected losses rather than the general rating scale of a traditional insurer. Also, the commercial insurance market has high administrative costs which are passed on to their clients within the premiums charged. A captive can reduce the overall cost of an insurance programme by retaining the premium for the expected losses, thereby avoiding the premium loading for a commercial insurer’s overheads and profits.

* **Protected Cash Flow** - Reserves for unpaid claims and unearned premium, otherwise kept by a commercial insurer, can be held by a captive and invested. This takes advantage of the captive’s ability to establish such reserves from pre-tax income that is not possible for a non-insurance entity.
* **Source of Additional Revenue** - A captive can expand its book of business by offering insurance to related third parties thereby generating an additional revenue stream for its parent. Some captives also write coverage for unrelated third parties through participation in various reinsurance pools or treaties.

***Insurance Advantages***

* **Reduced Need for Commercial Insurance** - As a captive matures and its net worth grows, it becomes capable of retaining a greater proportion of its owner’s risks. The increased use of a captive diminishes the owner’s dependence on commercial insurance.
* **Improved Negotiating Position** - As the captive’s ability to absorb risk grows, it improves the owner’s negotiating position with insurance and reinsurance markets.
* **Flexibility in Programme Design** - A captive provides opportunities to more easily structure insurance programs since the captive is not subject to the same constraints and conventions normally evident with traditional insurers.
* **Broader and Simpler Insurance Contracts** - A captive is usually domiciled where there is little, if any, regulation concerning policy wording, thereby allowing specifically tailored insurance and reinsurance contracts.
* **Better Risk Management Programme** - A captive facilitates the design of allocation systems to distribute costs more equitably among profit centres, the implementation of uniform accounting procedures, the accumulation of actuarial information, the design of more effective claims-handling, loss-control and engineering programs, and the unification of the application of risk management throughout

***Captive Disadvantages***

While there are many potential benefits in forming a captive, several disadvantages exist. Before deciding to establish a captive, an organisation should thoroughly assess the following potential disadvantages:

* **Capital Commitments** - The owner(s) must contribute the capital required to support the captive’s business plan, as determined by the insurance regulator in the captive’s chosen domicile. While these funds remain within the parent group, they may not realise the same return as they would have if invested in the parent’s operations.
* **Risk of Adverse Results** - The captive’s capital could be eroded by adverse operating results. Although it is normal to build into any captive programme a degree of protection against adverse underwriting results, it is only possible to minimise the risk to the captive, never eliminate it.
* **Operating Costs** - In its formation and operation a captive may incur various expenses including:
	+ Implementation costs.
	+ Management fees.
	+ Legal and auditing fees.
	+ Local taxes.
	+ Regulatory/licensing fees.
* **The amount of expenses and fees** will vary depending on the domicile chosen for the captive.
	+ Time Commitment - In addition, a captive will require some commitment of the parent company’s management time and precipitate some travel costs. Generally, these costs will be more than offset by the financial benefits of the captive program.

**4.0 THE WAY FORWARD & NEXT STEPS**

By forming a SIDS DOCK Captive Insurance Company, the sixteen members (16) of the SIDS DOCK organization and the fourteen (14) others in the process of joining would have an option under their control that they can collectively reduce costs, insure difficult risks, gain direct access to reinsurance markets, and increase cash flow for economic development, or, other priorities in the SIDS such as building resilience to climate change. Based on the decision at the 3rd Meeting of the SIDS DOCK Assembly, held September 23, 2017 in New York, at the United Nations, and the work by the Secretariat and members of the Executive Council, SIDS should consider hiring a professional consulting firm to perform a feasibility study to determine whether a SIDS owner-controlled insurance programme and captive insurance facility is feasible for the organisation. This financial and risk management analysis should provide the justification for transferring retained risk to a captive, rather than financing risk using commercial insurance or a self-financing program. If the legitimacy or wisdom of the risk financing program is subsequently challenged, a well-written feasibility study can be invaluable in defending the captive program.

**4.1 Next Steps**

***OPIC:***

* OCIP is a construction contractor procurement strategy. Organizing around the use of OCIP does not require that any member country satisfy any particular regulatory requirement (that we are aware of). As a first step, member countries who decide to implement an OCIP need to hire an insurance broker to administer the programme.
* Following the engagement of an OCIP Administrator (“broker”), participating countries merely have to modify contract requirements to require that contractors submit bids with and without insurance. Requiring bids with and without insurance will force contractors to identify their respective insurance costs and allow us to compare the various insurances as submitted against a program-specific OCIP insurance package.
* The OCIP Administrator will manage the bulk of the process.

***Captive:***

* The establishment and execution of a captive insurance strategy is a much more involved process. In most cases, standing up a captive is a six-month process. As noted in the timeline (Figure 1), there are several steps involved in the establishment of a captive. We estimate that the initial stage of strategy development - which includes the collection and review of basic underwriting data - will take between 30-60 days.
* Following the review of basic underwriting data, and once all participating countries agree to move forward, they will need to engage a professional insurance advisor to conduct a formal Captive Feasibility Study. The Captive Feasibility Study will take between 30-60 days to complete.
* Assuming that the results of the feasibility study are favorable to all participants, we estimate that another three months will be required before the captive will be operational.

***Figure 1: Proposed Captive Formation Timeline***



1. The Association of Trinidad and Tobago Insurance Companies (ATTIC) [↑](#footnote-ref-1)
2. http://www.ccrif.org/news/scaling-ccrif-spc-meet-region-needs-stakeholders-gather-chart-ccrif-strategic-direction [↑](#footnote-ref-2)
3. http://www.worldbank.org/en/news/speech/2017/10/13/after-the-storm-recovery-and-resilience-in-the-caribbean [↑](#footnote-ref-3)
4. http://thoughtleadership.aonbenfield.com/Documents/20180124-ab-if-annual-report-weather-climate-2017.pdf [↑](#footnote-ref-4)
5. http://thoughtleadership.aonbenfield.com/Documents/20180124-ab-if-annual-report-weather-climate-2017.pdf [↑](#footnote-ref-5)
6. http://www.ccrif.org/news/scaling-ccrif-spc-meet-region-needs-stakeholders-gather-chart-ccrif-strategic-direction [↑](#footnote-ref-6)
7. https://unfccc.int/files/press/news\_room/press\_releases\_and\_advisories/application/pdf/070406\_pressrel\_english.pdf [↑](#footnote-ref-7)
8. The Association of Trinidad and Tobago Insurance Companies (ATTIC) [↑](#footnote-ref-8)
9. http://www.worldbank.org/en/news/speech/2017/10/13/after-the-storm-recovery-and-resilience-in-the-caribbean [↑](#footnote-ref-9)
10. https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Gone-with-the-Wind-Estimating-Hurricane-and-Climate-Change-Costs-in-the-Caribbean-44333 [↑](#footnote-ref-10)
11. Government of Jamaica Fiscal Policy Report for the 2017-18 fiscal year [↑](#footnote-ref-11)
12. Caribbean Catastrophe Risk Insurance Facility, 2015, Understanding Caribbean Catastrophe Risk Insurance Facility: A collection of questions and answers, available at http://www.ccrif.org/sites/default/files/publications/Understanding\_ CCRIF\_March\_2015.pdf [↑](#footnote-ref-12)
13. Source? [↑](#footnote-ref-13)