Session 3: Roadmap for a CAREC Disaster Risk Transfer Facility

Islamabad, Pakistan
July 2023
Introduction: Recap of the Fundamentals
Requirement for Immediate Post Disaster Liquidity
Immediate Funding is Key

Source: Vivid Economics

- < 2 months after a disaster
  - Humanitarian response
  - e.g. Providing food, medicine, shelter

- < 9 months after a disaster
  - Restoration of basic services
  - e.g. Re-starting transport, energy supplies, markets

- > 4 months after a disaster
  - Reconstruction or rehabilitation of assets
  - e.g. Rebuilding infrastructure, homes, build back better
A different type of insurance

- Parametric policies respond to an event, not a proven loss like traditional indemnity insurance
- This means that loss payments can be made virtually immediately after the event
- No time and cost of post disaster loss adjustment
- Countries can buy insurance against windstorm, earthquake and excess rain
- Countries know the expected pay-out within 3 day (allowing them to plan/spend) and will have recovered the money within 14 days
Existing Regional Risk Facilities and Lessons for CAREC
Countries around the world have collaborated on regional risk financing, including in the Caribbean and Central America, in South America, in Africa, in the Pacific, and in Southeast Asia. A regional facility can serve one or several functions:

- **Collaboration**
  Sharing of best practice, of data, and of regional management to disaster risk

- **Arranging Risk Transfer**
  Facilitating risk coverage for participating countries, including insurance and ILS

- **Retaining and Sharing Risk (Risk Pooling)**
  A licensed and regulated insurance company to which countries transfer risks in exchange for premiums

**Level of Complexity and Involvement Increases**

Determining its function and form would be informed by factors including countries' needs in DRF, international cooperation and public and foreign relations policy goals of the countries and funding partners, and countries' levels of commitment to participate in a regional facility.
Existing Regional Risk Facilities

1Refers to the 2018 the Pacific Alliance catastrophe bond placement, which was a joint issuance to four sovereign entities, rather than a regional risk facility.
CCRIF SPC (formerly the Caribbean Catastrophe Risk Insurance Facility)
The First Regional Emergency Response Scheme

Background
- In 2004 Hurricane Ivan wreaked havoc in the Caribbean. It caused damage of nearly $4 billion (at current values), with severe loss and damage in Grenada, Jamaica and Cayman Islands; but social impact was much higher
- Aid was promised, and whilst some of it arrived it was too little and, crucially, too late. A reliable source of immediate post disaster funds that can reduce reliance on unreliable overseas largesse was needed.

Solution
- CCRIF SPC is a special insurance company owned by trust, with that trust representing the interests of Caribbean governments
- It offers parametric insurance policies to Caribbean governments

Successes and Challenges
- **CCRIF SPC insurance products work.** Over 14+ years CCRIF SPC has made 56 payments to 16 member countries totalling US$245 million. Every single payment has been made within 14 days of the event.
- **The cover is good value.** CCRIF SPC manages premium by use of its pooled capital augmented by reinsurance which can be purchased efficiently due to the diversity of its portfolio
- **CCRIF continues to grow and innovate.** Expanding coverage options, improving policy conditions and innovating to cover new risks.
- **The benefits are more than just insurance.** A catalyst for better risk understanding and post disaster response planning as well as supporting the sharing of ideas, data and best practices.
African Risk Capacity (ARC)
A Program with Capacity Building at its Heart

Background

- Formed in 2014 by the World Food Programme, African Risk Capacity (ARC) is an agency of the African Union with an associated mutual insurer.

Solution

- At its core ARC is a parametric drought/crop failure insurance pool, but more important is the work it does to improve risk understanding and emergency response after disasters within member governments.
- Before being allowed to buy cover, countries must obtain a Certificate of Good Standing, meeting minimum standards of financial probity.
- They must also commit to engage in risk management processes and ultimately to purchase appropriate insurance cover.

Successes and Challenges

- **Speed of payment in key.** ARC provides funds immediately after an event to protect, feed and rehouse those affected in an effort to save lives and reducing damages to livelihood.
- **The programme is cost-effective.** An Oxford University study for African Risk Capacity showed that $1 received immediately after a drought occurs is worth up to $5 of aid received later.
- **Basis risk must be balanced against benefit** when considering overall programme value.
Pacific Catastrophe Risk Insurance Company

Background
- Pacific Island Countries (PICs) are highly exposed to adverse natural hazards, including tropical cyclones, earthquakes, volcanic eruptions, and tsunamis
- PICs suffer an average of more than $280 million per year in damages from disasters\(^1\). Human and physical environments are also adversely impacted.

Solution
- The Pacific Catastrophe Risk Insurance Company (PCRIC) was established in 2016 to address climate and disaster risks across 14 PICs
- It is a specialised disaster risk insurance provider.
- Current product offerings include parametric insurance policies covering tropical cyclones and earthquakes (including tsunami)

Successes and Challenges
- To date, four pay-outs have been made for an aggregate amount of more than US$11 million.
  - Two were made under PCRAFI, the other half were made by PCRIC.
  - The pay-outs were all received immediately post-disaster(s) and were the first financial injections of emergency funds made into each country.

\(^1\)Source: https://pcric.org/
Pacific Alliance

Background
- The Pacific Alliance is a regional initiative that promotes the economic integration of Chile, Colombia, Mexico, and Peru.

Solution
- Joint issuance and marketing of catastrophe bonds to cover 4 countries.
  Issued in 2018 and covered US$1.36 billion earthquake risk for 2-3 years, the largest sovereign risk insurance transaction.
- Now exploring a new bond with new hazards, potentially including tropical cyclones, drought, floods and/or cold weather.

Successes and Challenges
- By working together, the interest in the deal was very high - the cat bond attracted more than 45 investors globally, ranging from ILS funds to pension funds to reinsurance companies.¹
- Peru received US$60 million in 2019 when a magnitude 8.0 earthquake triggered its catastrophe bond protection.

Lessons Learned from Existing Regional Facilities

1. The schemes work

2. Disaster risk modelling is essential for making informed management decisions

3. Basis risk, real and political, needs to be addressed

4. There must be a balance between product affordability and financial sustainability

5. Local/regional stakeholders' interests must be represented
Overall, the Benefits of Regional Risk Facilities Overcome Basis Risk
It’s Not All About How Much Is Paid Out

<table>
<thead>
<tr>
<th>Speed of Payment</th>
<th>Budget Certainty</th>
<th>Risk Awareness</th>
<th>Preparedness</th>
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<tr>
<td>The size of claim payment is known within days of event</td>
<td>Less reliance on central government / international generosity</td>
<td>A catalyst to improved risk understanding</td>
<td>Schemes can encourage development of detailed, audited contingency plans</td>
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<td>Payment is received shortly after</td>
<td>Pooling reduces exposure to re/insurance market price volatility</td>
<td>Supports risk-informed prioritization of disaster risk reduction actions</td>
<td>Provides a forum for shared expertise, potentially for shared resources</td>
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Options and Roadmap for a CAREC Risk Facility
Potential Structure for a CAREC Risk Facility
A Longer-Term Goal for Risk Transfer and Regional Cooperation

- Lower premiums and operational expenses
- Segregation of risk and no cross-subsidization
- Access to reinsurance and capital markets on competitive terms
- Improved risk analysis and information sharing
- Regional Cohesion

CAREC Disaster Risk Transfer Facility

- Policyholder of parametric insurance policies
- Country
- Country
- Country
- Country

Risk Modeler

- Hazard data
- Risk Transfer Cost
- Trigger payouts

Reinsurers/Capital Markets

- Fund support

External Donors

- Premium
- Claims

Claims

Premium
Key Considerations at Each Stage of Facility Development

Pre-Requisites
- Determine the role of the ADB
- Obtain countries formal request/confirmation to participate in the facility
- Conduct more detailed risk modeling in coordination with member countries

Stage 1: Facility Creation
- Country of domicile or recognition
- Operational entity or legal nature, including ownership structure
- Sources of initial capitalization
- Corporate governance structure
- Key advisors
- Initial product offering

Stage 2: Facility Operation
- Operational structure
- Alternative sources of capital required for longer-term financial sustainability
- Evolution of its products
- Country engagement program
Main Stages of CAREC Risk Facility Development and Roadmap

A Risk Facility Implementation Roadmap will facilitate discussions among the facility's key actors, allowing countries to finalize decisions on important matters and eventually craft plans for execution.

**Roadmap:**
- **Pre-requisites**
- **Stage 1: Facility Creation**
- **Stage 2: Facility Operation**

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<tr>
<th>Month</th>
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# Main Stages of CAREC Risk Facility Development and Roadmap

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<tr>
<th>Phase and Task</th>
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<tr>
<td><strong>Pre-requisites</strong></td>
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<tr>
<td>Determine the role of the ADB and the CAREC Secretariat</td>
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<tr>
<td>Obtain countries formal request/confirmation to participate in the facility</td>
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<td>Conduct more detailed risk modelling in coordination with member countries</td>
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<tr>
<td><strong>Facility Creation</strong></td>
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<td>Formal discussion between the ADB, participating countries and technical partners</td>
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<td>Propose composition of the CRF Steering Committee</td>
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<td>Outline the Facility Creation and Facility Operations decision</td>
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<td>Finalize Steering Committee Membership</td>
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<td>Agree dates for Committee’s inaugural meeting</td>
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<td>Propose draft agenda for first gathering</td>
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<td>Inaugural Steering Committee meeting</td>
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<tr>
<td><strong>Facility Operation</strong></td>
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<td>Agree general timeframes of decision-making on the facility</td>
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<td>Agree specific timeframes for each decision point in the Facility Creation and Operations stages</td>
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<td>Agree persons accountable and responsible for the due diligence exercises</td>
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<td>Agree other next steps identified by the Steering Committee</td>
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