Disaster Risk Financing & Insurance Program
SUPPORTED BY WORLD BANK GROUP

The fundamentals of Disaster Risk Financing and Financial Instruments

Analysis to Action:

An Executive Education Program on Disaster Risk Finance in Africa

2 – 6 September 2019

Stellenbosch University

S100 1918·2018

Agenda

- World Bank’s four core principles of Disaster Risk Finance (DRF)
- An overview of the range of financing instruments available to governments
- Introduction to the relative advantages and disadvantages of different financing instruments

What is DRF?

- ✓ Ensuring money reaches people who need it the most, when they need it the most
- ✓ Using Financial Planning to protect Investments in human development and productive assets
- ✗ Adapting to long-term climate changes and trends
- ✓ Planning on how to meet the cost of disasters before they happen
- ✓ Increasing the speed, predictability and transparency of disaster response
- ✗ Raising funds from International partners after a disaster
- ✗ Financing risk reduction and development

What is Disaster Risk Finance?

Protecting livelihoods and development

Increasing the Financial Resilience of the national and subnational governments, businesses, households, farmers, and the most vulnerable against natural disasters by implementing sustainable and cost-effective financial protection policies and operations.

Financial protection & DRM

Pillar 1: Risk Identification	Improved Identification and understanding of disaster risks through building capacity for assessments and analysis
Pillar 2: Risk Reduction	Avoided creation of new risks and reduced risks in society through greater disaster risk consideration in policy and investment
Pillar 3: Preparedness	Improved capacity to manage crisis through developing forecasting and disaster management capacities
Pillar 4: Financial Protection	Increased Financial resilience of governments, private sector and households through financial protection strategies
Pillar 5: Resilient Recovery	Quicker, more resilient recovery through support for reconstruction planning

- Disaster Risk Finance is one component of a comprehensive approach to risk management
- Financial protection complements, but does not replace, risk reduction and resilience measures

Four Primary Groups impacted by natural disasters and climate risk

GOVERNMENT

HOME/BUSINESS OWNERS

FARMERS/HERDERS

THE POOREST

Government

Emergency borrowers, struggling to find money in a time of crisis	Effective risk managers, planning ahead and being prepared
Take away already budgeted resources and disrupt planned spending	Dedicated resources are available for disaster response, protecting planned investments and public services.
Difficult and long negotiations with providers of support and within government to prioritize spending, have to take place during an emergency.	Negotiations are carried out in advance and clear rules and financing mechanisms are in place that allow everyone to focus on the response.
Financial assistance particularly for subnational governments and households is uncertain and unpredictable.	Subnational governments and households know in advance when they will receive assistance and how much, allowing for improved planning.

Four Core Principles of DRF

Timeliness of Funding

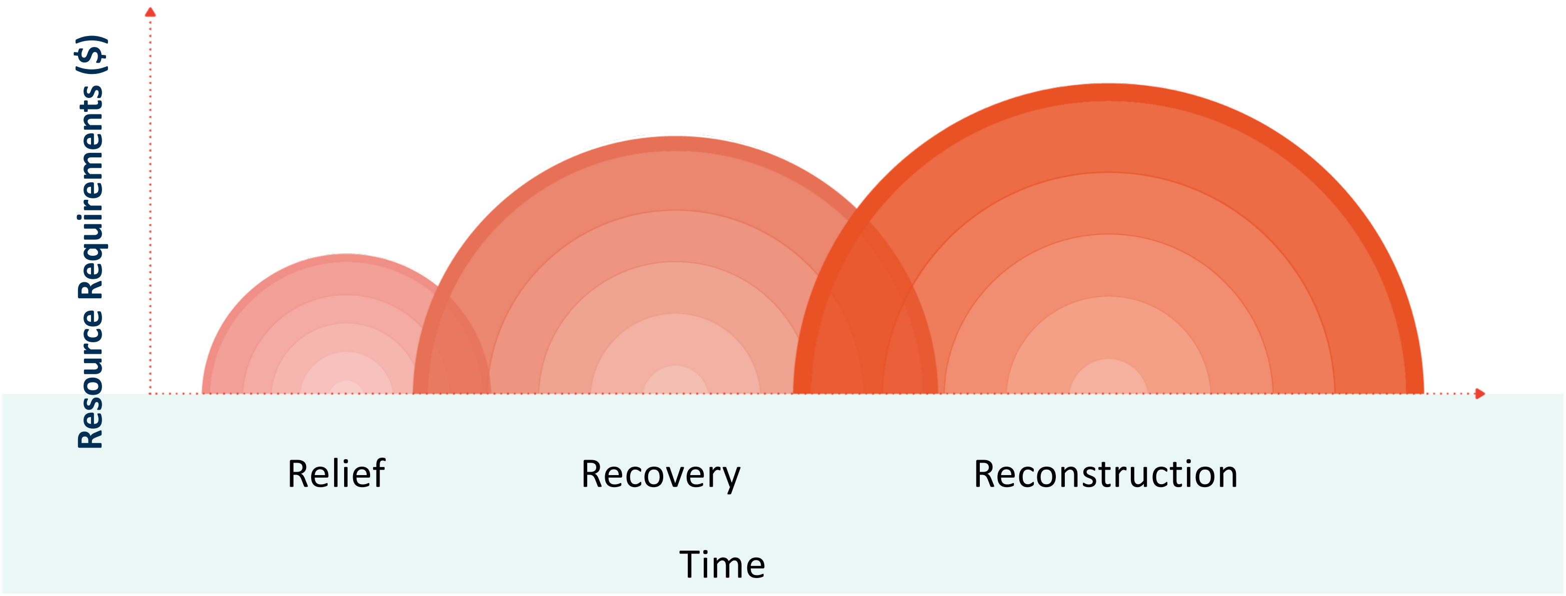
No One Financial Instrument
Can Address All Risks

How **money reaches beneficiaries is as important** as where it comes from

To make sound financial decisions **you need to have the right information**

Core Principle 1

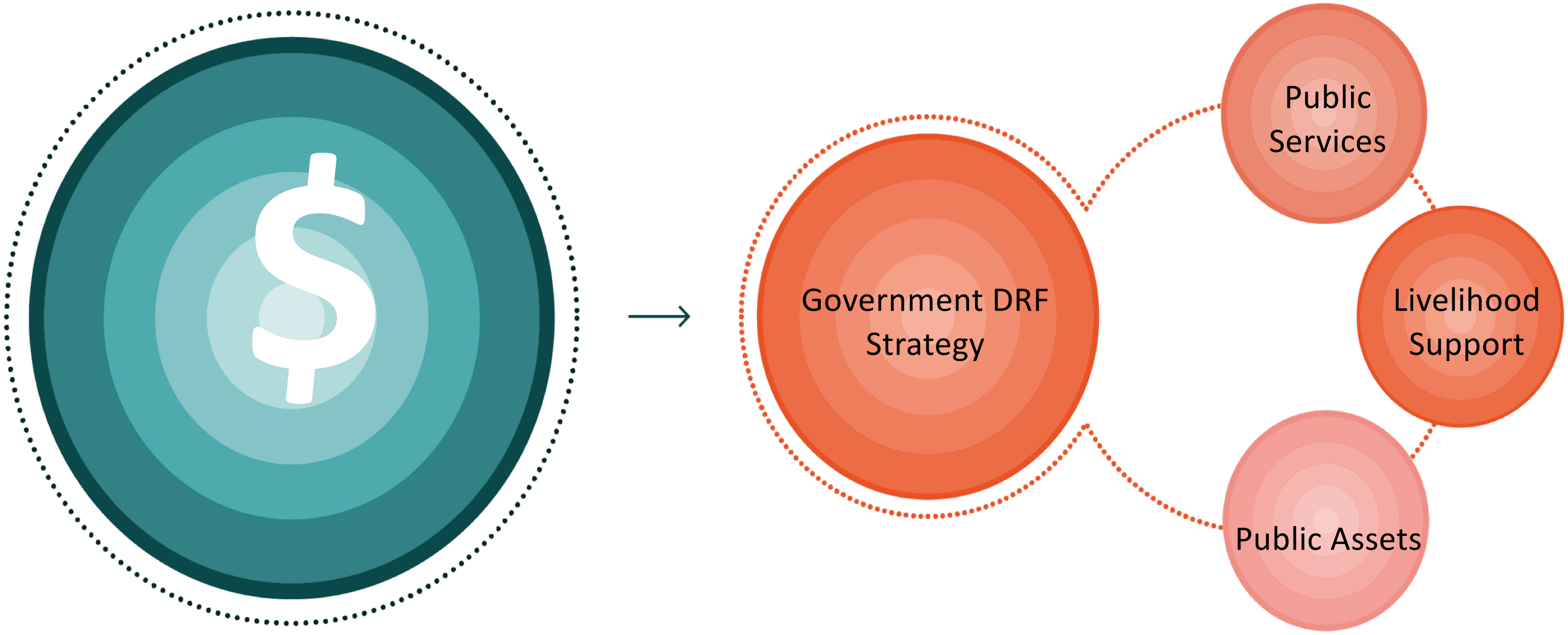
Timeliness of funding



Speed matters, but not all resources are needed at once.

Core Principle 2

How money reaches beneficiaries is as important as where it comes from



Core Principle 2

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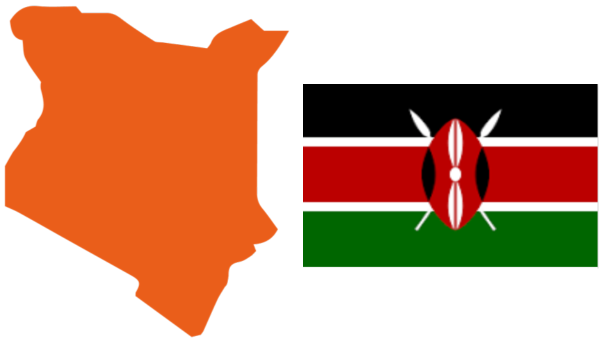
Development Challenge

large drought exposure and the poor have limited capacity to absorb shocks and often resort to extreme coping mechanisms



Solution

- HSNP is an unconditional cash transfer program operating in four of the poorest, drought prone ASAL counties of Kenya
- **Effective distribution mechanism for post disaster assistance**
- Provides regular, timely and electronic cash assistance to beneficiaries via bank accounts using pin/biometrics identification
  - Up to **100,000 routine households**
- Scales in response to drought shocks
  - Can scale up to **272,000 additional households**
  - But they need to have a bank account
- 60% of beneficiaries are women

Core Principle 3: Disaster Risk Layering

No single Financial instrument can address all risks

HAZARD TYPE	FINANCING INSTRUMENT			
Low Frequency/ **High** Severity	Market-Based Instruments	**Risk Transfer**	Risk transfer for assets such as property insurance or agricultural insurance and risk transfer for budget management like paramedic insurance, cat bonds/swaps	International Assistance (uncertain)
	Contingent Financing	**Contingent Credit**	Financial instruments that provide liquidity immediately after a shock	
High Frequency/ **Low** Severity	Budgetary Instruments	**Budget Reserves/ Reallocations**	Reserve funds specifically designated for financing disaster related expenditures, general contingency budgets, or diverted spending from other programs	

Core Principle 4: Data and Analytics

To Make Sound Financial Decisions you need to have the right information

Loss Data (Historical Data/CAT Risk Model

Microeconomic Data

Financial and other Data

DRFI ANALYTICS

Quantitative Analytics

Financial Decision Making Tools

Financial Impact Analysis

Cost Benefit Analysis

Understanding Financial Impact of Disasters

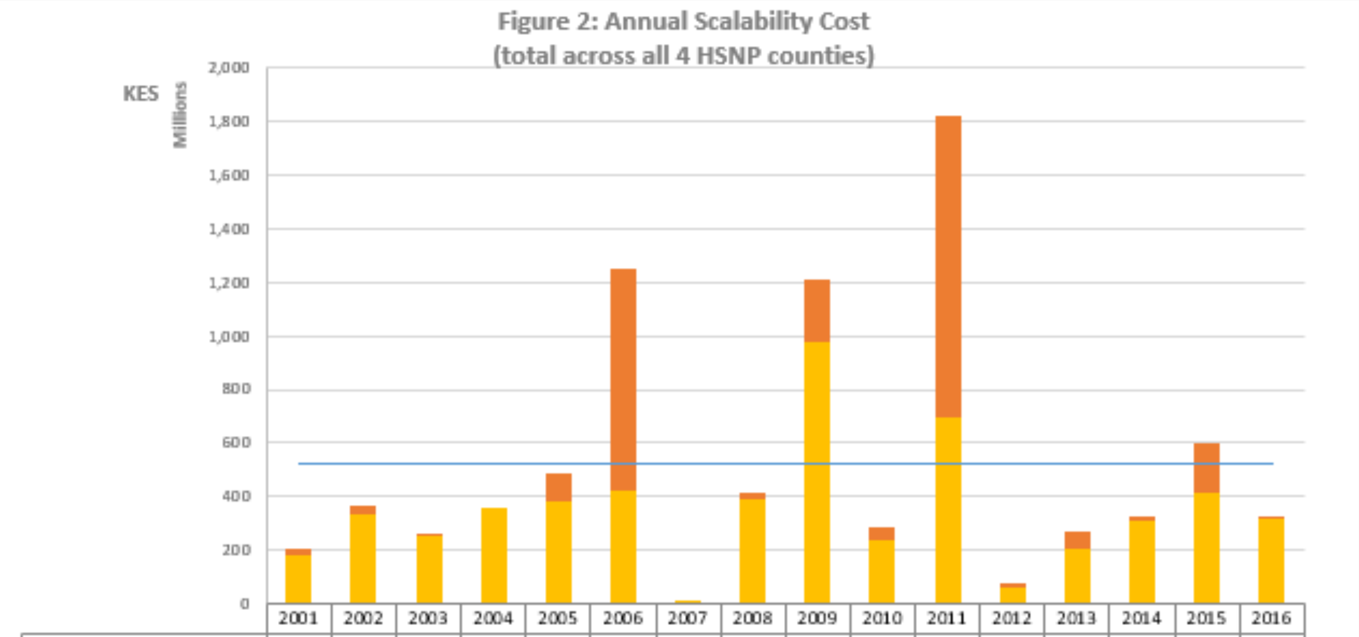
Make evidence based financial decisions

Leverage private financial markets using quantitative outputs

Monitor and evaluate DFRI strategies

Core Principle 4: Data and Analytics

KENYA HUNGER SAFETY NET PROGRAM



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Extreme Payout	29.1	33.5	2.0	0.0	100.7	824.4	0.0	29.2	236.1	49.0	1,124.7	11.7	64.7	12.8	181.1	9.7
Severe Payout	178.0	332.5	251.2	359.5	386.1	423.9	9.3	388.4	977.5	234.3	697.2	63.4	204.7	314.2	415.6	314.9
Average Annual Payout	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9	522.9

Delivery mechanism (safety net program)

Risk information and early warning system

Disaster Risk financing

Effective risk financing solutions

COORDINATED PLAN For post-disaster action agreed in advance

Fast, evidence-based **DECISION-MAKING PROCESS**

PRE-PLANNED FINANCING to ensure plan can be implemented

- Ensures funds are available quickly when–and only when–they are required
- Binds partners to pre-agreed objectives, decision processes, and implementation and modalities
- Promotes greater discipline, transparency, and predictability in post-disaster spending
- Ensures rapid mobilization of funds, reducing humanitarian costs and potentially saving money

Based on Dull Disasters (2016). Clarke and Dercon.

Build plan, fundraise, and implement

Common instruments used for financial planning

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Emergency budget reallocation Emergency tax increase Post-disaster Credit
Risk transfer (removing risk from the balance sheet)	Traditional insurance/reinsurance Index insurance, reinsurance, or derivatives Capital market instruments	Discretionary post-disaster relief from development partners

Build plan, fundraise, and implement

Common instruments used for financial planning

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Requires Discipline	Undermines Discipline
Risk transfer (removing risk from the balance sheet)	Supports Discipline	

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Examples:

- Humanitarian aid
- Crisis response grants/loans from development banks

Advantages	Disadvantages
• Flexible – can respond to need • Accurate (?)	• Can be slow and costly • Can be unreliable • Undermines planning

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Examples:

- Emergency budget reallocation
- Emergency tax increase
- Post-disaster Credit

Advantages	Disadvantages
• Can be cheap (but not always)	• Often slow • Can be unreliable • Undermines planning • Can negatively affect other investments

Build plan, fundraise, and implement

Common instruments used for financial planning

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
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Examples:

- Contingency fund or budget allocation
- Line of contingent credit

Advantages	Disadvantages
• Can be cheap, particularly for frequent shocks • Fast • Allows implementers to plan	• Requires fiscal discipline • Opportunity cost of undisbursed capital • Sometimes hard to defend

Five Steps

Towards Strengthening Financial Resilience

1. Take Stock of how disaster response is currently financed
2. Gather risk information/carry out risk assessments
3. Decide on policy priorities
4. Build financial protection strategy
5. Work with and improve existing processes for DRF

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