

DISASTER RESERVE FUNDS

Introduction to instrument

Disaster reserve funds are an important part of an efficient risk-layering approach. They allow governments to retain risk as part of their budget but still set resources aside in advance to facilitate rapid response in case of a shock, with clear prearranged processes and procedures for how the funds can be used.

A fund can be established in different ways. In some countries the reserve fund is just a contingency allocation in the budget with specific rules for how these funds will be used. In other countries, a disaster fund is established as a dedicated institution, either a government agency or a de facto semi-independent service agency. In both cases, a disaster fund aims to improve disaster outcomes by (i) ensuring effective access to sufficient resources for disaster response; and (ii) streamlining execution and transparency of spending.

Uses / advantages / disadvantages

Disaster reserve funds have multiple uses:

- They fulfill key policy objectives by strengthening financial resilience and improving the financial management of disasters.
- They provide the government with readily available resources for post-disaster expenditure to enable emergency relief and response as well as long-term recovery, including rehabilitation and reconstruction.
- They serve as a center for promoting knowledge and building capacity on disaster risk financing within government, and they facilitate effective risk transfer through the purchase of (re)insurance.
- They can complement other disaster risk financing approaches / instruments as part of the government's financial protection strategy, including to promote research and risk assessment.
- They act in alignment with key processes and systems that enable the flow of funds to get to the point of need for effective recovery.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Make funds immediately available for disbursement to enable faster recovery and minimize longer-term impact of disasters 	<ul style="list-style-type: none"> • Involve opportunity cost of reserves retained in good years between disaster events • Involve time delays while accumulating an appropriate level of

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- Improve transparency concerning who is responsible for various risks
 - Improve timeliness of response (allocation of funds) and reduce administrative delays
 - Improve transparency and accountability regarding public expenditures
 - Provide either an alternative or complementary offering to insurance
 - Reduce dependency on debt financing following disaster
 - Enable inter-agency coordination for readiness, recovery, and risk transfer
- reserves to cover disaster risks and following any depletion of funds
 - Require careful fiscal management and modeling to ensure funds and/or risk transfer capacity match exposure liability
 - Require processes, systems, and resource capability to ensure funds are distributed efficiently and transparently to the intended beneficiaries
 - Can be mismanaged as reserves build up
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Mechanics

Establishment of a disaster fund requires actions to complete the legal and operational setup, allocate resources, develop a risk financing strategy, and strengthen the fund's operational performance and transparency. The specific steps will differ depending on the policy, legal, and institutional form of the country's specific disaster fund.

The key steps to implementing a disaster fund are these:

1. **Coordination for establishment, policy design, and legal basis.** Establishing a disaster fund is complex and requires strong coordination across national government ministries. Actors should agree on which ministry is responsible for the fund, identify the fund's specific objectives as part of the government's overall disaster risk finance strategy, and establish the fund through a legal mandate.
2. **Fund design (decisions on how the fund will meet its policy objectives).** Choices need to be made about what the fund will finance and how (the products to be offered), participants and beneficiaries, timing of participation, fund obligations, fund powers, and fund and product governance and setup (i.e., fund activities and staffing).
3. **Financial design (decisions on how the fund will be funded).** Choices need to be made about the fund's financial risk appetite and risk management strategy, the extent of risk transfer, accumulation levels, funding ratios, financial structure, and investment options.
4. **Regulatory (legislative) design. Choices need to be made about how** the fund (and its products) will be created and monitored (i.e., about the regulatory instruments and tools used).
5. **Ongoing review and fine-tuning.** The fund's operation must be proactively monitored and adjustments made to ensure the overall mandate is achieved.

Example

To strengthen Indonesia's fiscal and financial resilience to natural disasters, the government is establishing a Pooling Fund for Disasters (Pooling Fund untuk Bencana, PFB) and is strengthening systems for the transparent flow of these disaster funds. This is the key reform of the country's National Disaster Risk Finance and Insurance Strategy, adopted in 2018. The objectives are to (i) reduce fragmented funding by providing a mechanism through which post-disaster financing can flow from different sources and actors; (ii) ensure reliable and predictable prearranged funding; (iii) streamline disbursement channels for quick and efficient flow of funds from the PFB to implementing agencies; and (iv) leverage domestic and international financial markets. This effort is being supported by the World Bank through a US\$500 million loan. The PFB will leverage domestic and international insurance and reinsurance markets to support more efficient disaster response by providing financial capacity to backstop the fund and by drawing on expertise and technology for managing payouts.

More information

<https://www.worldbank.org/en/news/press-release/2021/01/21/strengthening-indonesias-fiscal-resilience-to-natural-disasters-and-health-related-shocks>

"World Bank. 2012. FONDEN: Mexico's Natural Disaster Fund--A Review. World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/26881> License: CC BY 3.0 IGO."

"OECD; World Bank. 2019. Fiscal Resilience to Natural Disasters: Lessons from Country Experiences. OECD: Paris. © OECD and World Bank. <https://openknowledge.worldbank.org/handle/10986/32341> License: CC BY-NC-ND 3.0 IGO." Description on disaster funds in various countries