Executive Education Program on Disaster Risk Finance for Indonesia

SESSION : Introduction to Financial Protection of Public Assets

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Disaster Risk Financing & Insurance Program
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Learning Objectives

- An understanding of what is the financial protection of public assets and examples from other countries
- An understanding of why the financial protection of public assets is important
- An understanding of how the financial protection of public assets is designed, developed, implemented, and renewed

Part 1

What is Financial Protection of Public Assets?

What is a Public Asset?

Assets responsible for delivering a wide range of government functions and public services.

Includes education, health, and administration

Often expands to include critical infrastructure such as roads, water services, power, and assets owned by sub-national government and through public private partnerships (PPPs)

What is Public Asset Financial Protection?

Asset Custodian

Governments have a mandate to deliver public services

The facilitation of public services involves asset ownership (e.g., schools)

Asset Risk Exposures

Assets are exposed to various damage and destruction risks (including disasters)

Note: Unlike other entities, government may not have the same choices when it comes to avoiding hazards. Services need to follow the population.

Contingent Liabilities (Financial Impacts)

Response
Emergency Response Costs (e.g., make safe, temporary service provision)

Recovery
Asset repair & reinstatement costs

Direct

Reduced Revenue and increased costs of borrowing

Indirect

Financial Protection of Public Assets

A coordinated, pre-arranged strategy for funding the financial impacts of public asset damage and public services disruption

Funding will typically be a combination of :
- internal sources such as budget reserves or contingency funds (risk retention)
- external sources such as insurance or sovereign borrowing (risk transfer)

Effective ex-ante risk financing of direct impacts, helps minimize the indirect impacts

What is Public Asset Financial Protection?

National DRFI Strategy Priorities:

Protecting State and Sub-National Assets

Protecting all households and people affected by disasters, especially low-income people

Quickly restore the livelihoods of communities affected by disasters

Strengthen the roles of sub-national governments, community, and private sector in disaster risk financing

Developing the domestic insurer market

Protecting public finance

Public Asset Financial Protection Actions to date:

Implementing the ABMN Program

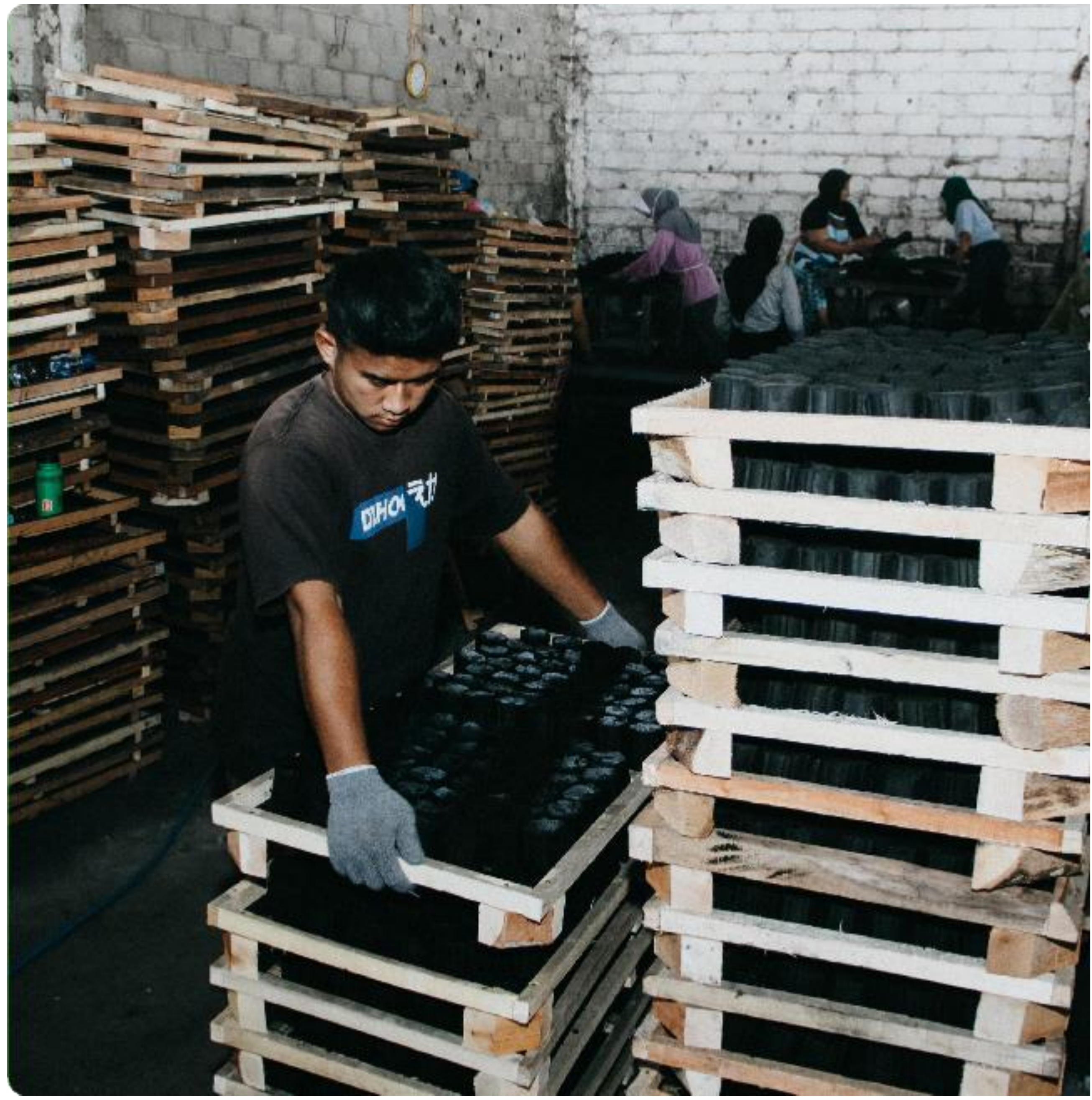
Developing insurance products with local insurance markets

Training & Education of relevant stakeholders

Exploring collaboration between central government and sub-national government

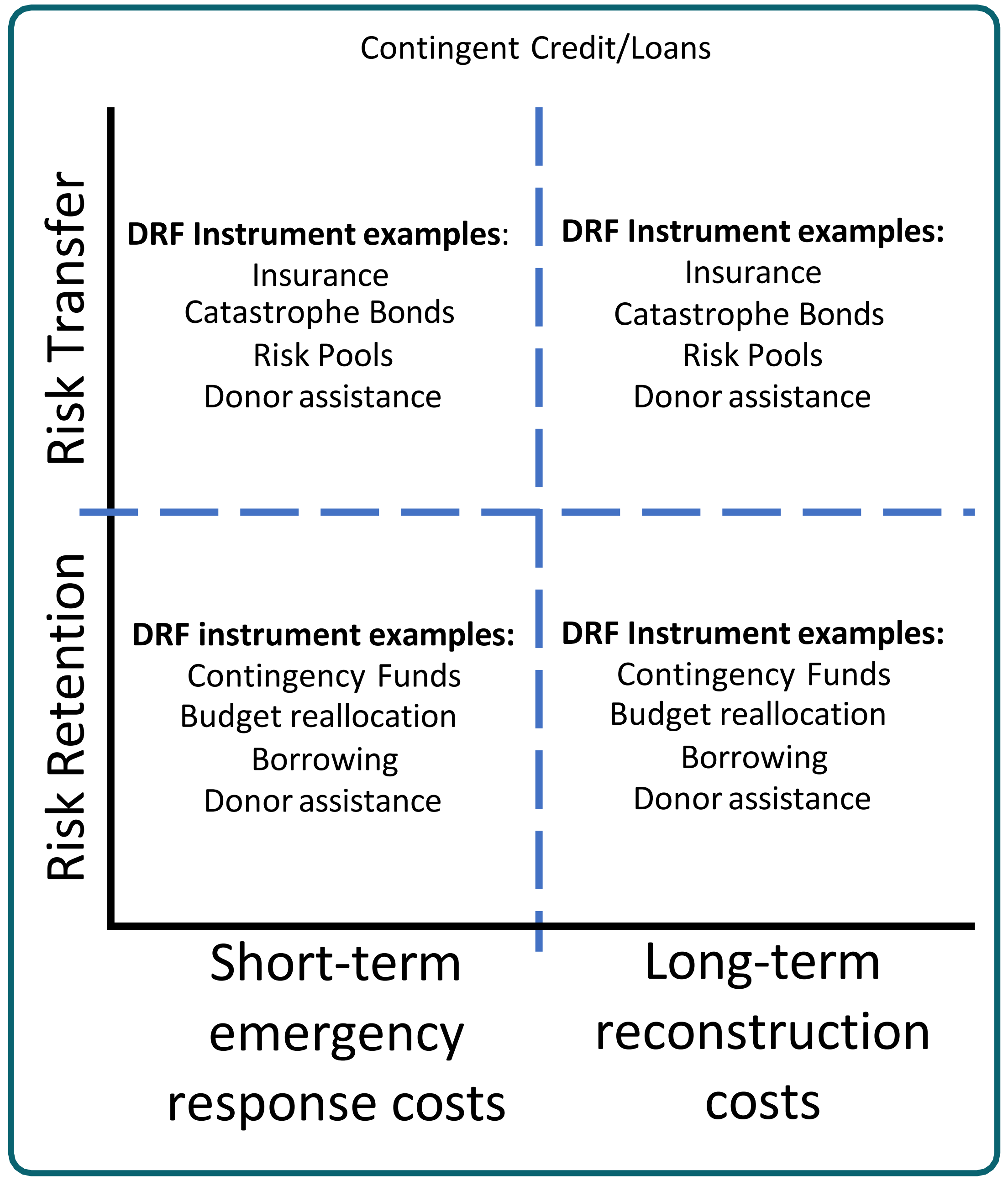
Exploring potential alternative risk financing instruments

Exploring future integration with the PFB

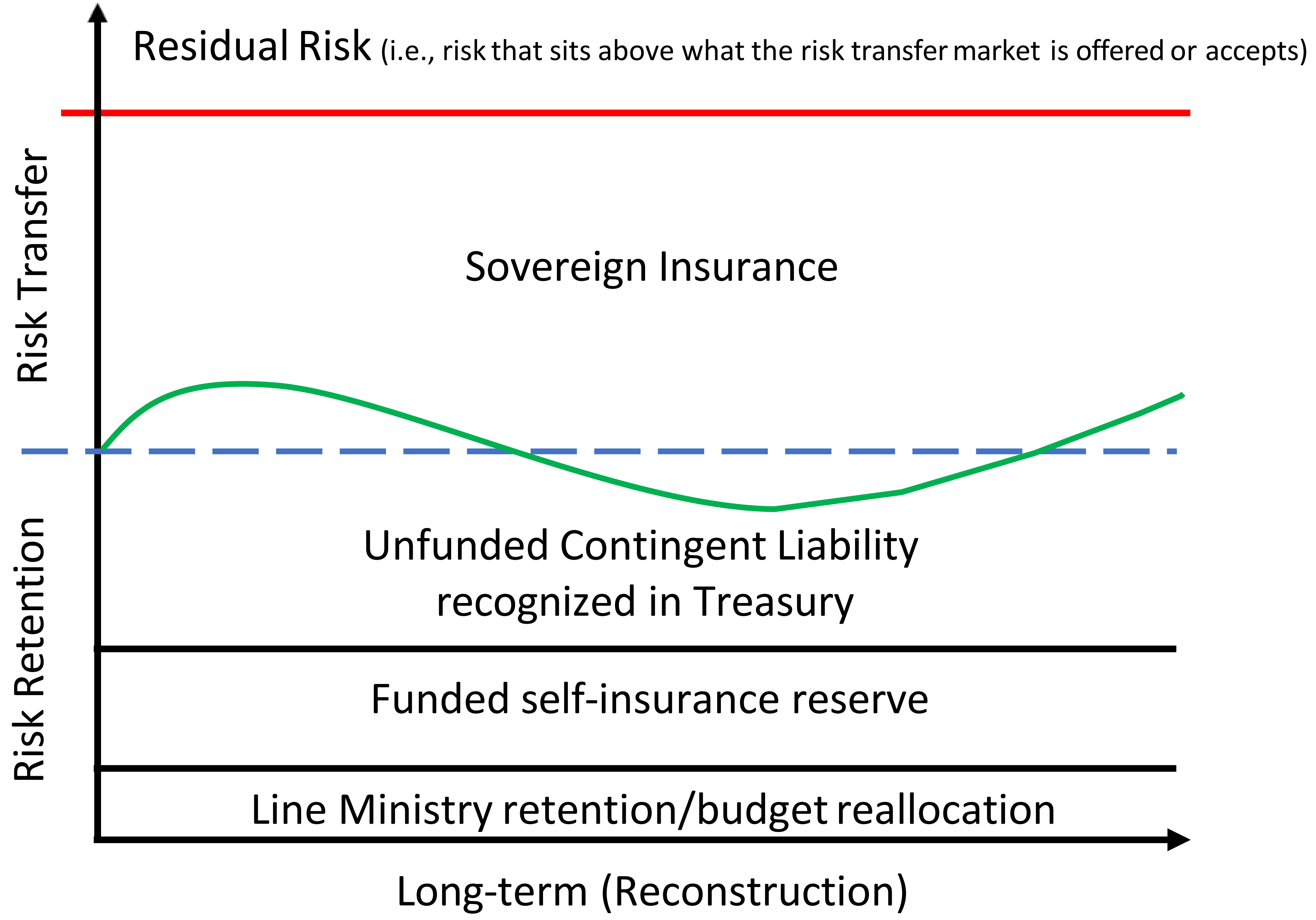


What is a DRF Program?

- **A coordinated, pre-arranged strategy for funding the financial impacts of disasters on public assets and public services delivery, involving:**
  - An evidence-based understanding of the risk exposures and contingent liabilities
  - A split between risk retention and risk transfer based on the most cost-effective sources of capital
  - A combination of complementary DRF instruments so that funding is diverse and not subject to a single point of failure
- **DRF Programs are constructed of various combinations of DRF instruments (i.e., a plug and play arrangement)**
- **The combinations can be customized to the circumstances and priorities of the respective government**

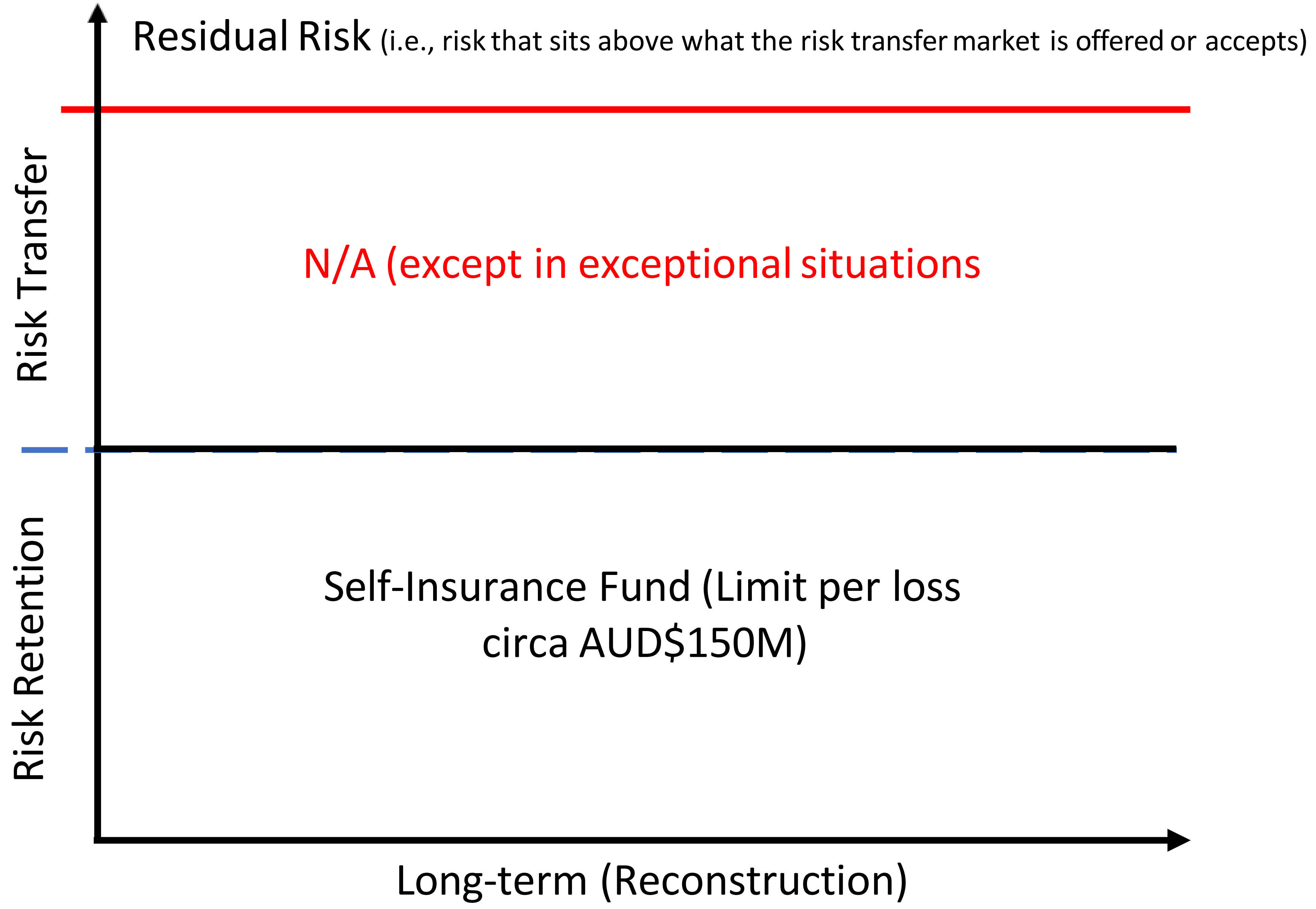


Examples of DRF Program structures – New Zealand – A future Strategy



- Centrally managed, administered and procured insurance (from local and international markets)
- The underlying Treasury layer can shift depending on market pricing, to manage premium pricing cycles
- Centrally managed and administered. Funded via premium/contribution charges to participating line ministries

Examples of DRF Program structures – Australia – A self-insured approach



No risk transfer is purchased (i.e., government carries residual risk above the self-insured retention)

Centrally managed and administered (Comcover). Funded via premium/contribution charges to participating line ministries

Examples of DRF Program structures – Philippines – A balanced approach

Residual Risk (i.e., risk that sits above what the risk transfer market is offered or accepts)

Risk Transfer

National Indemnity Insurance Program (NIIP)

Catastrophe Bond/Parametric Insurance

Risk Retention

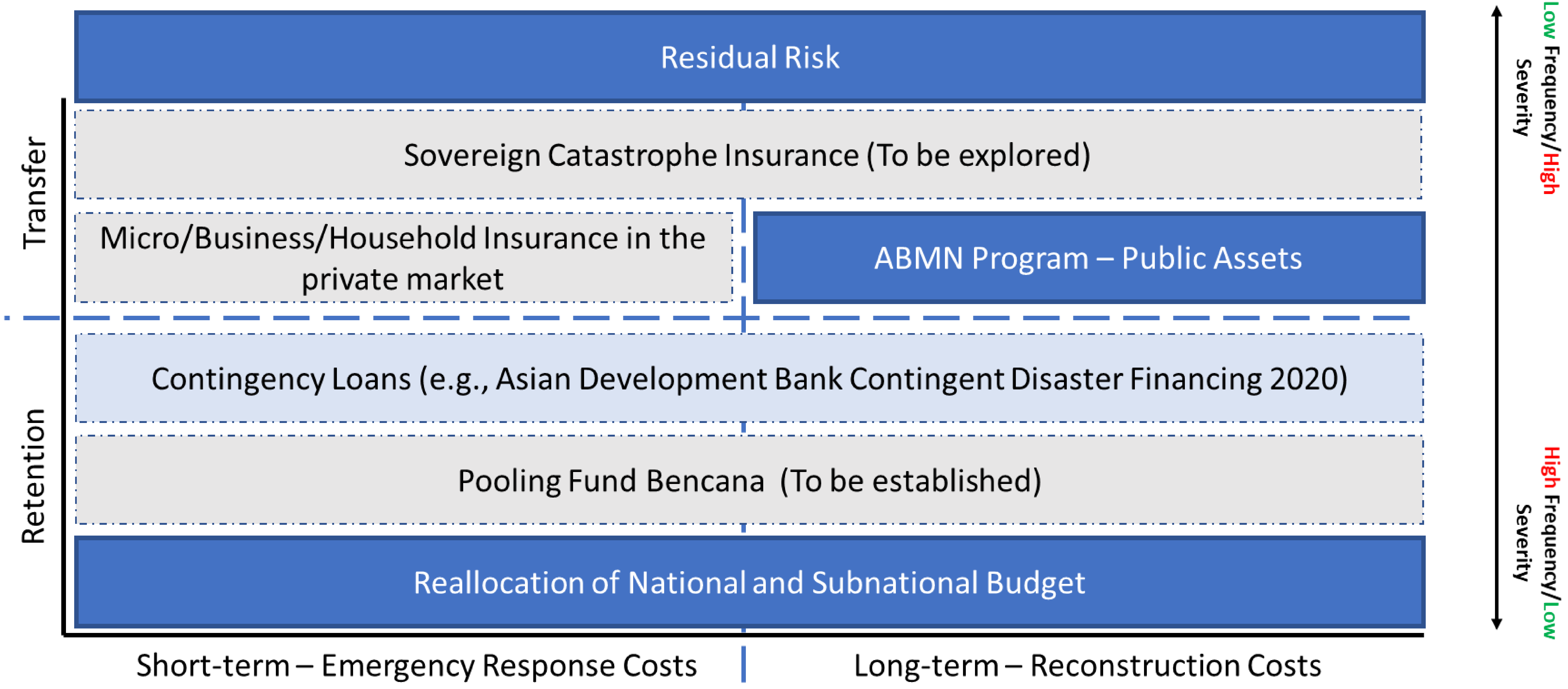
Government Services Insurance System (GSIS) Self Insured Retention – PhP2b per loss event

Long-term (Reconstruction)

Insurance is procured centrally by the GSIS. In some years, the insurance is complimented by other DRF instruments such as Cat Bonds

The GSIS has the legislative mandate to manage and administer a centralized self-insurance fund (funded by premium charges to participating government agencies and appropriations from central government)

Examples of DRF Program structures – Indonesia – A comprehensive plan



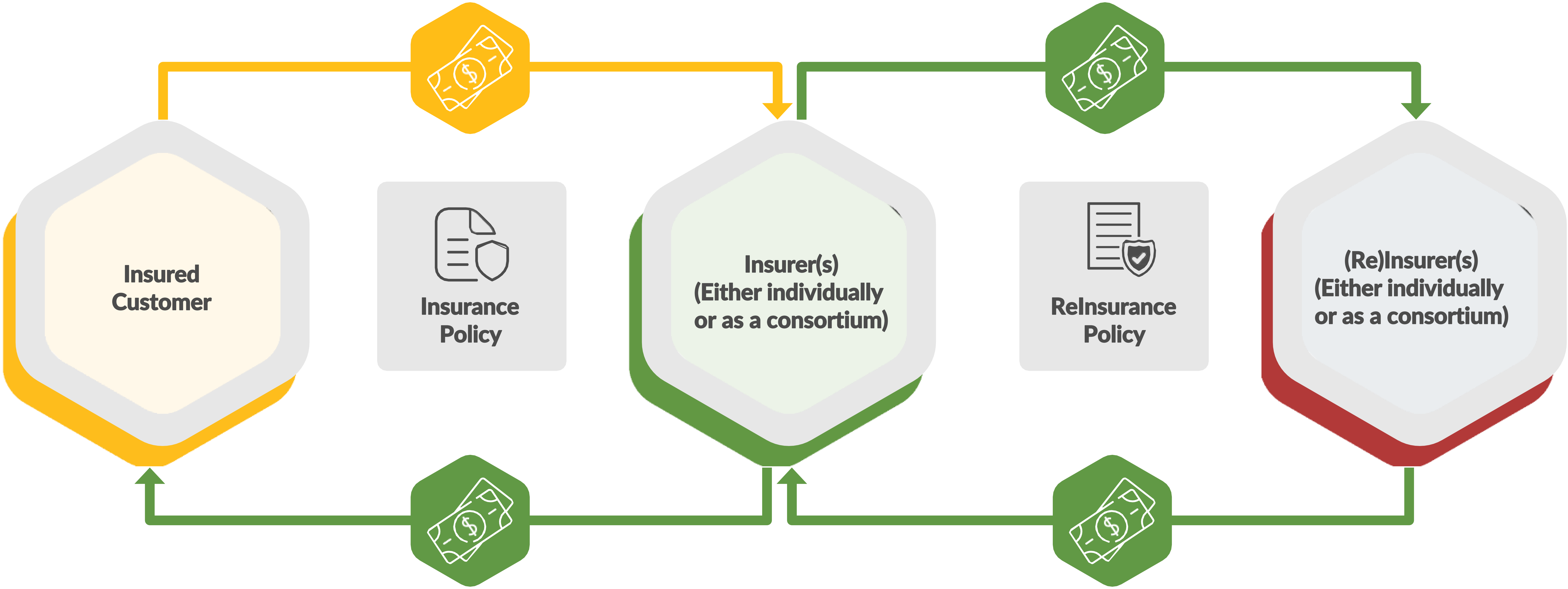
What is public asset insurance?

- Insurance is a way to transfer the financial consequences of a sudden, unforeseen event (e.g., natural disaster) to another party
- A strategic government relationship with the insurance industry to transfer public asset insurable risk exposures (e.g., natural disasters, fire, malicious damage) away from government
- The contract between the insured and the insurer is called an insurance policy
- The insurance policy is an agreement that if the insured pays a premium, the insurer promises to pay for covered losses for the term of the agreement
- The insurance policy is a negotiable agreement that lays out the specific terms and conditions of the promise
- Subject to insurance policy terms and conditions, the insurance claims settlement will pay for asset repair/replacement/ reconstruction costs

What is public asset insurance?

Insured pays a premium for the promise of financial protection based on insurance policy terms and conditions

Insurer pays a premium for the promise of financial protection based on reinsurance policy terms and conditions (usually for exceptionally large losses and/or a high volume of smaller losses)



Insurer pays the claim in accordance with insurance policy terms and conditions

Reinsurer pays a set proportion of a claim if the reinsurance policy is triggered

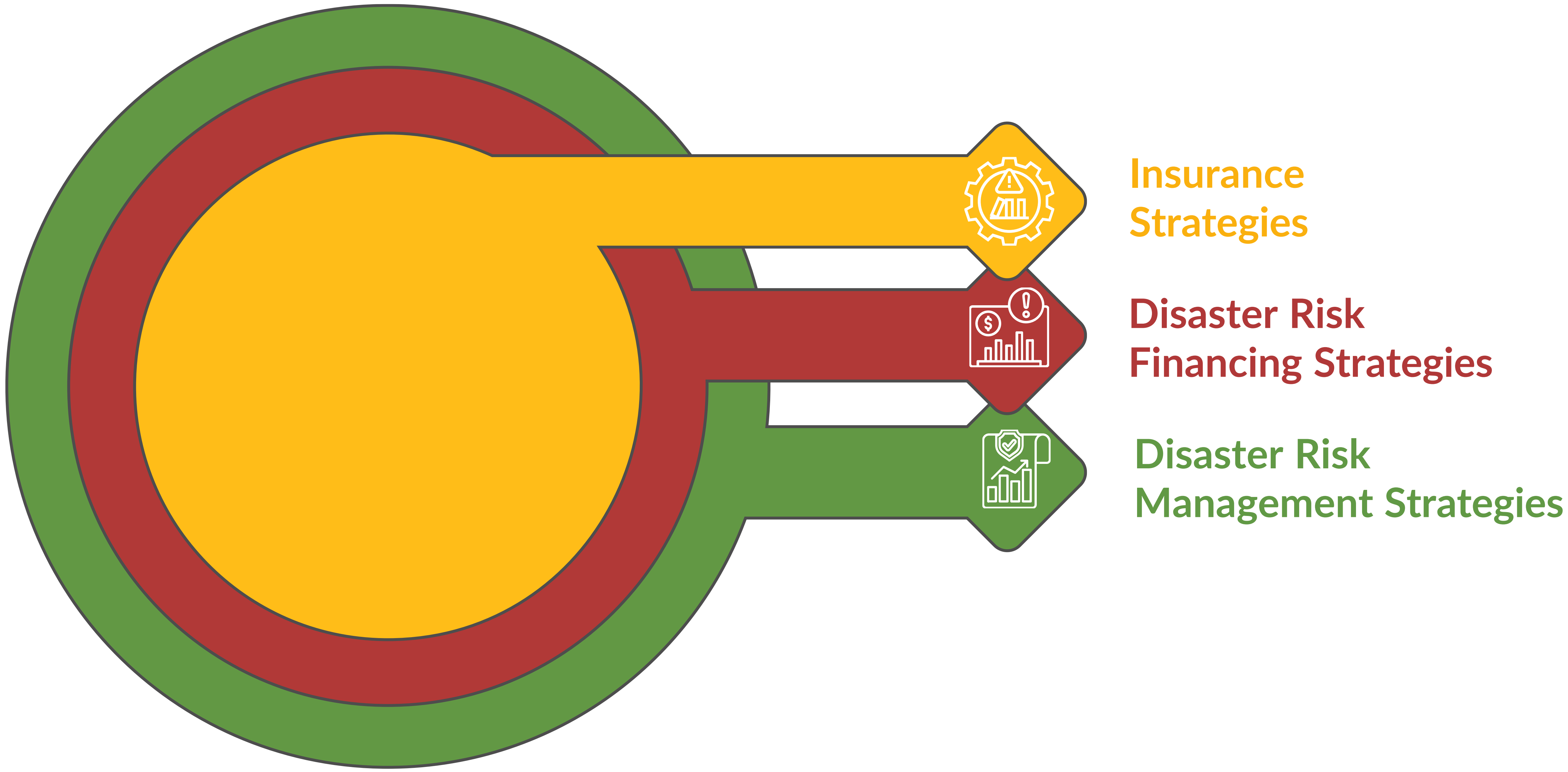

BAKSO!

Part 2

Why is Financial Protection of Public Assets important?

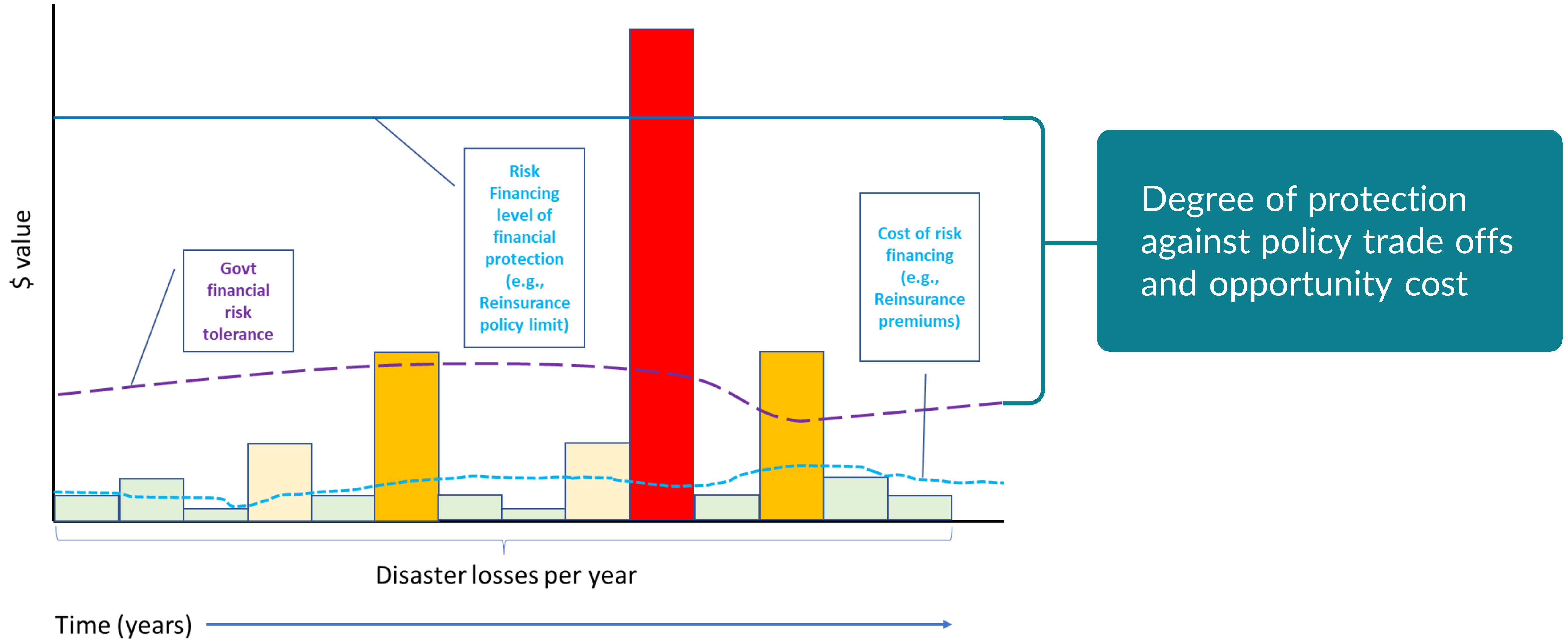
Economic, Physical, Social, Fiscal Resilience

- Best practice DRF programs work in synergy with DRM programs to improve resilience
- Informed by quality data and analytics, critical public assets and services can be identified and prioritized for protection
- Pre-arranged funds can be disbursed to the right beneficiaries in a timely manner
- DRM strategies, such as risk reduction investments, can make the insured more attractive to insurers, resulting in insurance premium discounts



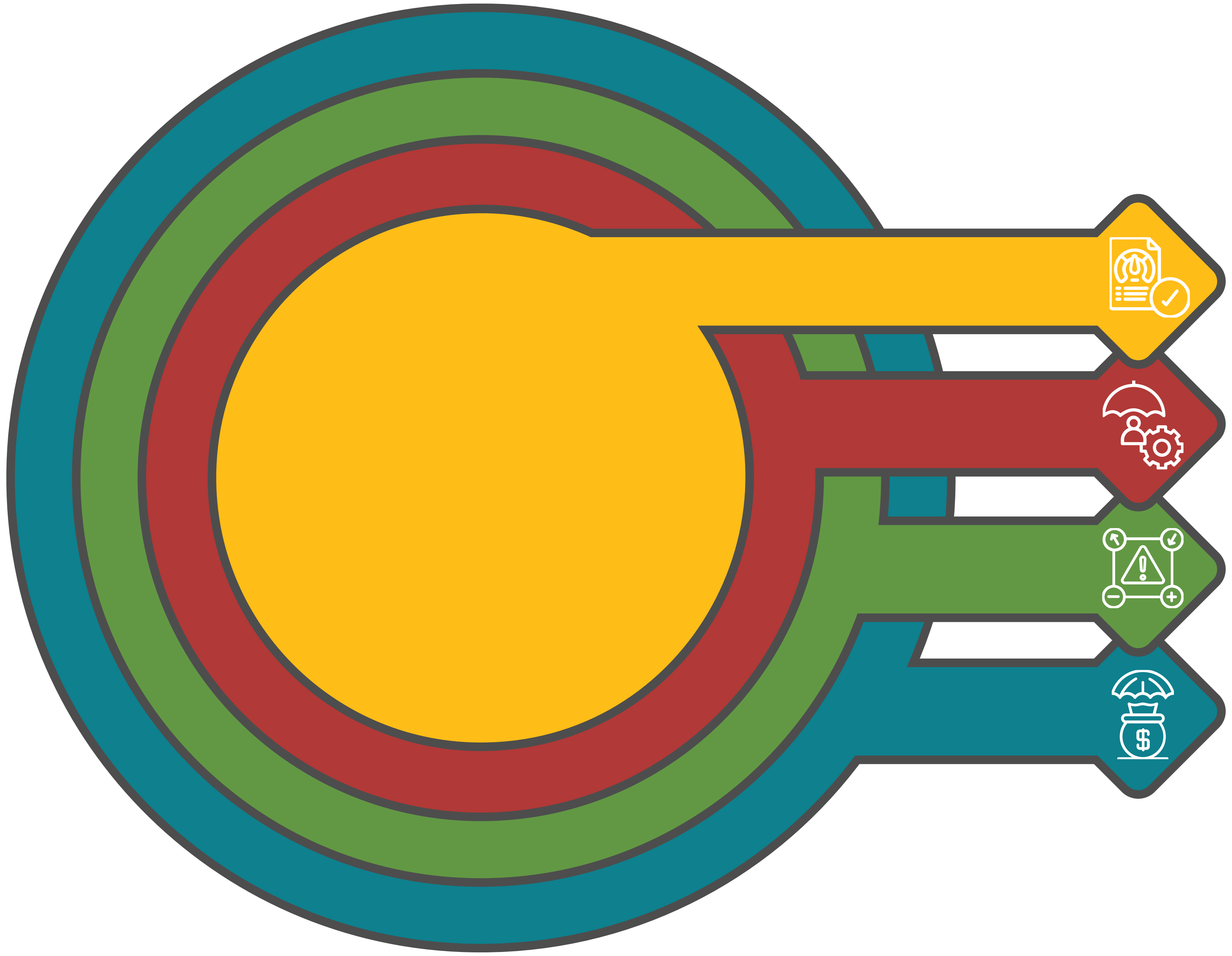
Minimizes opportunity cost and trade offs

- Sometimes disaster related costs will be more than government can afford.
- On occasion, this will be significant and put pressure on the government balance sheet.
- This will postpone other government agendas as funds are diverted to management of crises.
- The regular, relatively affordable and predictable cost of (re)insurance premiums allows government to fund financial risk beyond its financial means (i.e., a known, manageable cost versus potentially very large costs at uncertain points in the future).



Provides confidence for infrastructure investment

- Where financial protection certainty exists, there is greater confidence to commit to intergenerational asset investment
- Lending institutions are considering DRM/DRF arrangements as a criteria in decisions to lend for infrastructure projects



Insurance Strategies	Insurance is used when it presents as a sensible source of capital
Disaster Risk Financing Strategies	DRF arrangements reflect the risk exposures and potential financial impacts
Disaster Risk Management Strategies	Appropriate, customized asset risk management practices are embedded
Governance	Approvals and performance evaluation pathways ensure DRM/DRF considerations are scoped into investment decisions

Looking after people

- Businesses, productive sectors, communities, and individuals rely on public assets and services to maintain themselves
- Moral and legal obligation for government to be a key agent in social cohesion and security
- A government which wisely protects itself, is more capable of supporting the public calls for assistance post disaster event

Part 3

How is Financial Protection of Public Assets designed, developed, implemented, and renewed?

The stages of Public Asset Financial Protection Programs

Design

The creation of a business strategy and objectives for the financial protection of public assets in line with government policy (e.g., asset management)

Development

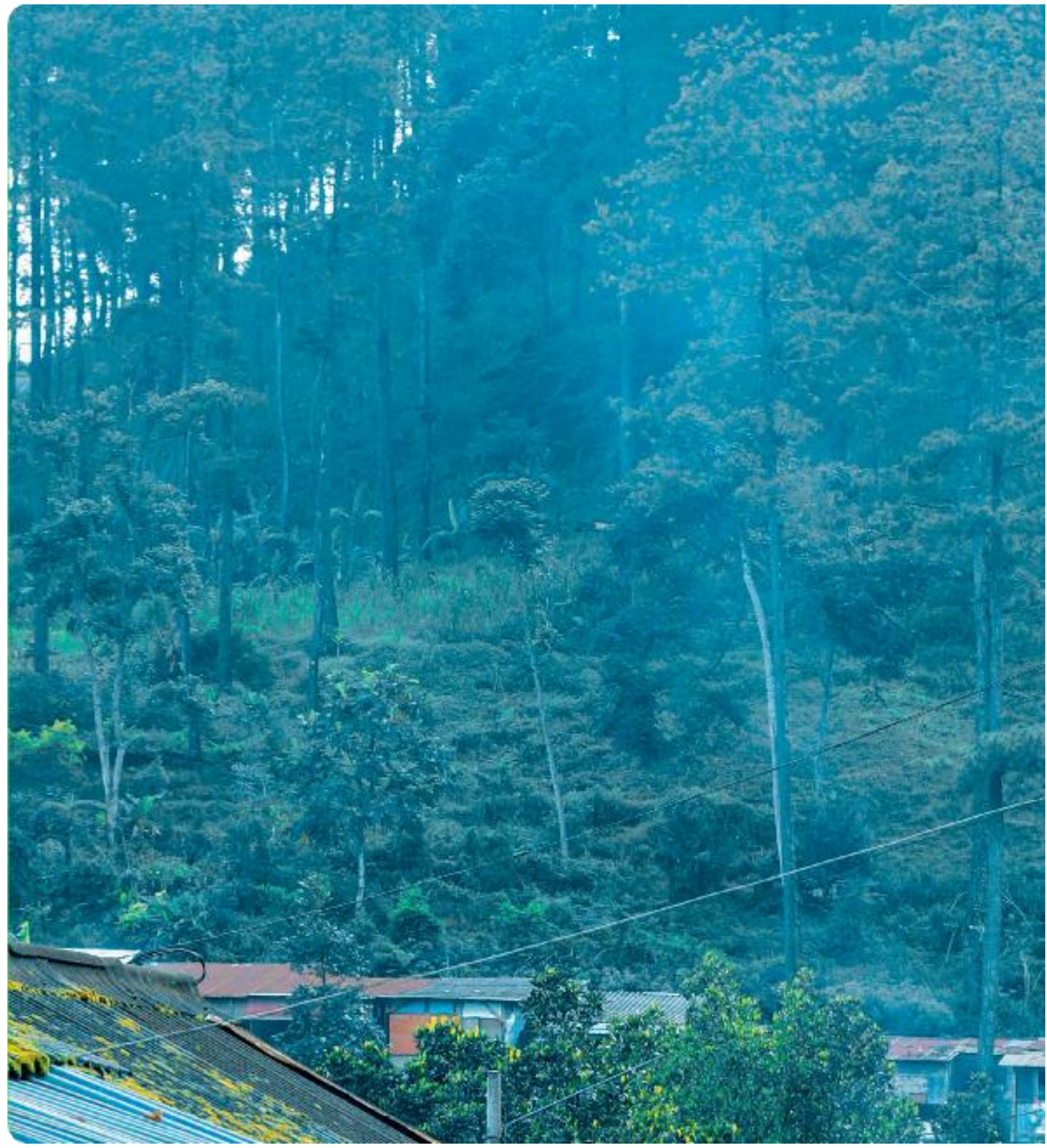
The assessment of risk and the establishment of an effective and sustainable financial protection program to achieve the strategic objectives in line with the risk appetite

Implementation

Implementing the insurance/disaster risk financing program with clear procedures to ensure efficient payout of claims and transparent accounting, in accordance with protection terms and conditions

Renewal

Regularly assessing, adapting, and sustaining the objectives of the program to address evolving risk exposures and market trends, while maintaining cost effectiveness and long-term viability



Public Asset Financial Protection Roadmap

01 Strategic Alignment
Agree on principles and align with government's overall risk management objectives

02 Legitimacy
Develop and support mandate through policy and legislative frameworks and direct ministerial ownership and accountability

03 Budget Planning
Set the appropriate financial budget to cover the costs of the program

04 Evidence Gathering
Develop understanding of the possible losses arising from risk exposures of public assets, and the existing financial protection arrangements

05 Options Assessment
Identify and assess risk financing options that balance trade-offs between risk retention and risk transfer

06 Decision-making
Select preferred option for delivery

07 Set Up Risk Financing Solutions
Establish to risk funding instruments, including procurement of risk transfer solutions

08 Preparation and Operationalization
Undertake recruitment, procurement, set up of operational governance, IT, comms and training

09 Annual Service Cycle
Planning review, claims management, and preparations for renewal

10 Continuous Improvement
Review and applications of lessons learned

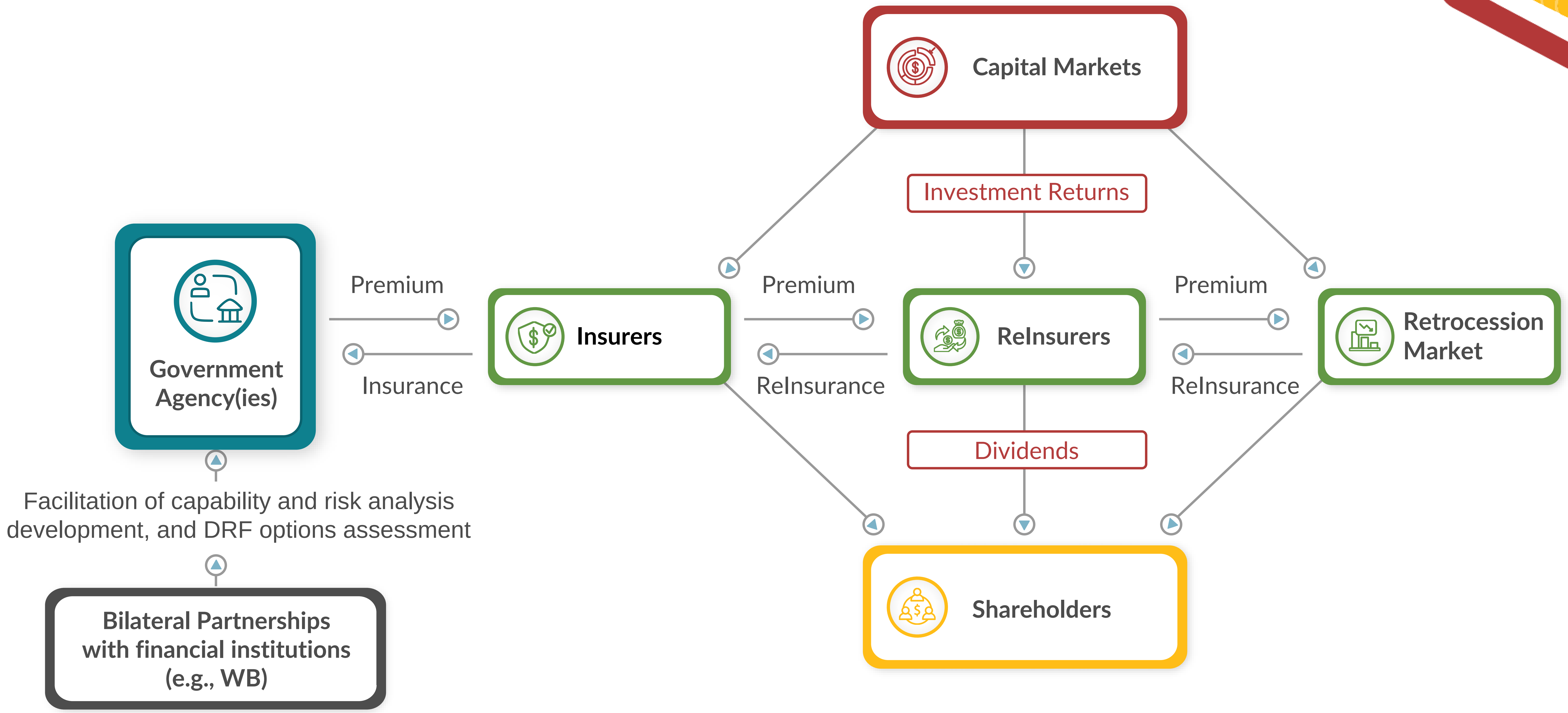
Key considerations

- Accurate and relevant data is critical (including valuations reflecting replacement value)
- Capability building through targeted and effective training and education opportunities
- Leadership and advocacy to promote the value proposition of the program and motivate participation
- Engagement with industry to best understand the risk financing options available

Claims Management

- Claims are where the ‘rubber hits the road’
- Having well prepared and rehearsed claims processes is important for effective and efficient claims settlements after a loss event
- DJKN has recognized this and has arranged for Claims Management Stress Test Exercises (STEs) to be delivered to line ministry staff
- STEs simulate disaster events so claims processes can be test run in advance of a real loss

Context - Key Insurance Stakeholders



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