Financial Protection of Public Assets
Master Class

Overview
Fundamentals of Disaster Risk Financing

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Learning Objectives

This session frames the content provided in the balance of this Masterclass event. You will see the principles and enablers, introduced here, further expanded upon in the following sessions.

What do we want you to take away from this session?

- An understanding of how DRF Programs fit within a broader DRF strategy
- An understanding of the principles of a best practice DRF programs
- An understanding of the enabling environment for successful, sustainable DRF programs
- An understanding of the core structure of a best practice DRF program
- Other considerations to account for when creating a DRF program
The Fundamentals of Disaster Risk Financing Programs

What is a Public Assets DRF Program

**A Public Asset DRF Program** is a coordinated, pre-arranged strategy (often a component of a National DRF Strategy) for funding the financial consequences of disaster impacts on public assets.

**A National DRF Program** is a coordinated, pre-arranged strategy for funding the broader fiscal, economic, and social costs of a disaster that fall upon government.

**A DRF Program** is a coordinated, pre-arranged strategy for funding the financial consequences of a disaster.

**Public Asset DRF Programs:**

- Contribute to financial management of governments' disaster-related contingent liabilities
- Reflect public service delivery priorities
- Reflect public asset criticalities
- Complement disaster risk management, disaster risk reduction, and asset management policy agendas
What are the basics of a Public Assets DRF Program?

1. **Timeliness**
   DRF delivers funds when they are needed

2. **Targeted**
   DRF responds to the right hazards

3. **Directed**
   DRF funds are allocated to the right beneficiaries

4. **Diverse**
   DRF is an effective combination of complementary instruments
What are the concepts of a DRF Public Assets Program?

**Timeliness of Funding**

Speed matters but not all resources are needed at once.

- Immediate liquidity is crucial to support relief and early recovery operations
- Government has more time to mobilize the larger resources for reconstruction
- This variation in the timing of needs has clear implications for the design of cost-effective DRF
What are the concepts of a DRF Public Assets Program?

**Funding targets the recognized perils**

Funding targets the recognized perils

- Different disaster events will impact in different ways.
- Geography and topography often dictates the types of disasters a nation can face
- Concentrated populations may increase the severity of impact of disaster events
- DRF needs to account for a nation's disaster risk profile
What are the concepts of a DRF Public Assets Program?

**Funding needs to be well directed**

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

- Governments require dedicated mechanisms to effectively allocate, disburse, and monitor recovery and reconstruction funds.
- Strong collaboration between the ministry of finance and the public entity tasked with spending post-disaster funds—such as local governments, DRM agencies, and agencies that maintain public infrastructure—is crucial.
- The disbursement system must balance policy makers’ concern for fast disbursement with the transparency and accountability required by the public and donors.
What are the concepts of a DRF Public Assets Program?

**Funding source diversity and layering**
No single financial instrument can address all risk.

International experience has shown that governments ideally combine different instruments to protect against events of different frequency and severity.

This approach, known as risk layering, is part of a comprehensive financial protection strategy that mobilizes different instruments, either before or after a disaster strikes, to address the evolving need for funds.

Risk layering ensures that cheaper sources of money are used first and that the most expensive instruments are used only in exceptional circumstances.

**Hazard Type**

- **Low Frequency**:
  - **High Severity**
    - Market-Based Instruments
    - Contingent Financing
  - **Low Severity**
    - Budgetary Instruments

- **High Frequency**:
  - **Low Severity**
    - International Assistance (uncertain)
What are the enabling factors of a sustainable DRF Program?

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<thead>
<tr>
<th>Enabling factors</th>
<th>Description</th>
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<tbody>
<tr>
<td>Supporting legislation/ regulation/ policy</td>
<td>Legislation/regulation that authorizes the strategy. This is important because it describes how the disaster-related financial risks of government will be handled (i.e., Public Financial Management). Without this legislation, the strategy has no mandate.</td>
</tr>
<tr>
<td>Accurate and available data (e.g., a public asset register)</td>
<td>Data is critical for understanding what populations, assets, and services are at risk, which are more critical than others, and how vulnerable they are to disaster events. A lack of quality data typically results in higher premiums as insurers price in ambiguity.</td>
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<tr>
<td>An understanding of the types and severity of disasters</td>
<td>Knowing what disasters can impact the country (both in terms of how often and how severe) helps build the country’s risk profile. When realistic disaster scenarios are plotted against the population and asset footprint, a government has a way to predict what the impacts will be.</td>
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What are the enabling factors of a sustainable DRF Program?

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<td>An understanding and consensus on DRF priorities</td>
<td>An agreement on what requires greatest focus. For instance, are there particular sectors of society or asset types that require focused protection? This is important because it will drive decisions about how DRF funds will be used.</td>
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<tr>
<td>Set roles and responsibilities</td>
<td>Who is responsible for designing the DRF solution? Who will manage and administer the solution when it is implemented? Who will participate in the solution, and how? How will the strategy be governed and audited? Who are the other stakeholders and what will they do?</td>
</tr>
<tr>
<td>Financial resourcing</td>
<td>How will the design and development stages be funded? It will take some time and resource to reach activation stage, and this will need a budget.</td>
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# The general construct of a DRF Program? (Plug and Play instruments)

## Residual Risk

This is where government transfers emergency response and recovery costs above the risk retention. This is usually to pass on the disaster costs above government’s short-term financial tolerance, and may include:

- Parametric Insurance (pays out if a specified event happens)
- Catastrophe Bonds
- Regional Risk Pools.
- International
- Donor Assistance

## Risk Transfer

- This is where government transfers reconstruction costs above the risk retention. This is usually to pass on the disaster costs above government’s financial tolerance, and may include:
  - Traditional (indemnity) insurance (pays out after proof of loss)
  - Parametric Insurance (pays out if a specified event happens)
  - Catastrophe Bonds
  - Regional Risk Pools
  - International Donor Assistance

## Risk Retention

- This is where government retains emergency response costs. To manage the need for quick cash, the funding instruments are usually one or more of:
  - Dedicated Disaster Funds
  - General Contingency Fund
  - Budget reallocation
  - Borrowing
  - International Donor Assistance

- This is where government retains reconstruction costs. This is usually to self-manage low impact events and/or to reduce the costs associated with risk transfer (e.g., insurance premiums)
  - Dedicated Disaster Funds
  - Self-insurance Funds
  - General Contingency Fund
  - Budget reallocation
  - Borrowing/tax increases
  - International Donor Assistance

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### Figure

- **Risk Retention**
- **Risk Transfer**
- **Residual Risk**

- **Hazard Type**
  - Low Frequency
  - High Frequency
  - Low Severity
  - High Severity

- **Short-term (Emergency Response & Recovery)**
- **Long-term (Reconstruction)**

- **There can also be a layer that bridges between risk retention and risk transfer. This can be used when it offers cheaper access to funds than risk transfer (e.g., insurance) for certain layers of financial impact. This can include contingent credit/loans from financial institutions and/or bilateral partners.**
Other considerations

Risk is dynamic. Review your DRF Program on a regular basis as DRF instruments may need to develop and change with you.

Risk retention is an important tool because:
- Having government/line ministries be financially responsible for a layer of disaster related costs incentivizes prudent risk management.
- As risk transfer market prices move up and down, risk retention can be used to insulate against price hikes.

Use relevant expertise when it is available. Informed decisions will always be better decisions.

Remember, risk transfer contracts are negotiable instruments.

The cost of risk capital swings in favor of retaining more risk (e.g., higher retentions).

When indications are the price has ‘bottomed out’ and premium rates may increase soon, it may be sensible to negotiate a long term agreement with insurers.
What are the key takeaways?

Public Asset DRF programs should be a component of a government’s broader DRM/DRF strategy

DRF programs should be customized to account for:
- When funds will be required post-event
- The disaster perils faced by the nation
- Who will need the funding post-event
- The most effective and efficient use of capital (risk retention vs risk transfer)

To be successful and sustainable, DRF programs need to be supported with:
- An effective mandate via legislation/regulation
- Quality data and data analysis
- A clear sense of risk exposure priorities
- Concise roles and responsibilities
- Sources of adequate funding

Risk transfer options require engagement with a nuanced financial services market