Reducing and Managing Disaster Risk through Financial Services IDB Approach

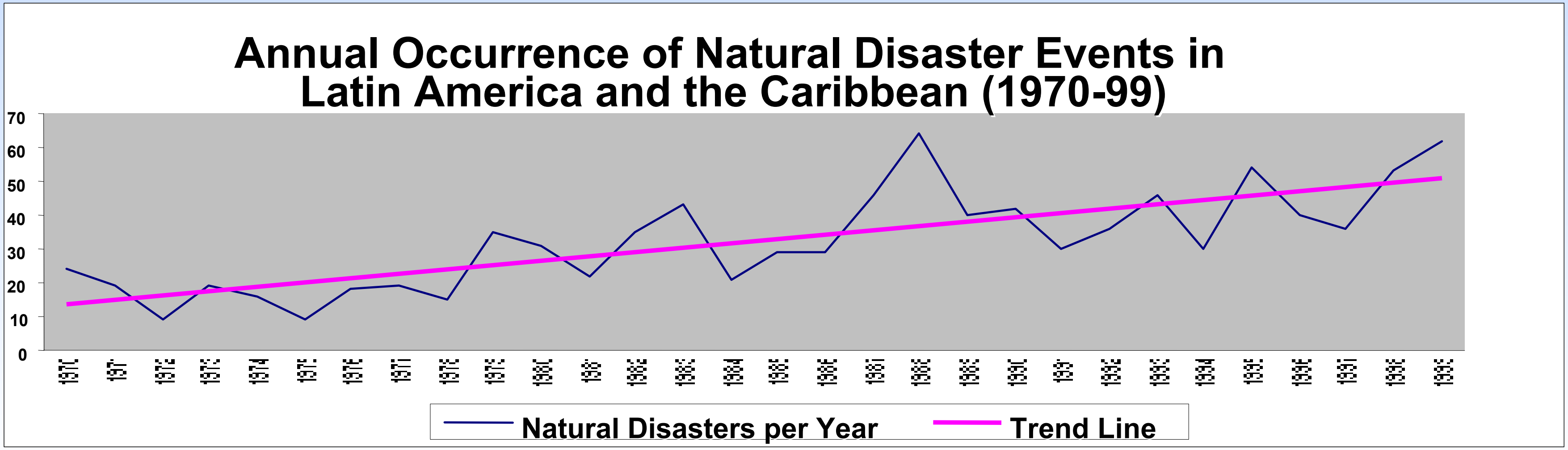
Kobe, Japan
January, 20, 2005

Toshio Kobayashi
IDB

Risk Profile for Latin America and the Caribbean

Latin America and Caribbean have a high damage propensity from natural hazards and the tendency is increasing.

- Annual regional losses to disasters since 1975: 5,000 deaths; physical losses worth US$3.2 billion; 4 million people affected.
- Only one of 12 countries analyzed in a recent IDB study has economic capacity to finance recovery and reconstruction from a 500 year natural hazard (2% chance of this event occurring during the next 10 years)



Strategic Elements of Disaster Risk Management

- Integrated risk management
- Prevention is an investment
- Reduce vulnerability and protect the poor
- Participation of the private sector and civil society
- Coordination of international financing
- Mobilize resources from existing financing mechanisms
- Develop new financing mechanisms including markets for insurance.

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

Disaster Risk Financing in Latin America and the Caribbean

- Governments assume part of the risk of the private sector
- Risk is insufficiently transferred through insurance
- Donors assume part of the risk for the countries

→ Reliance on external agents as providers of last resort

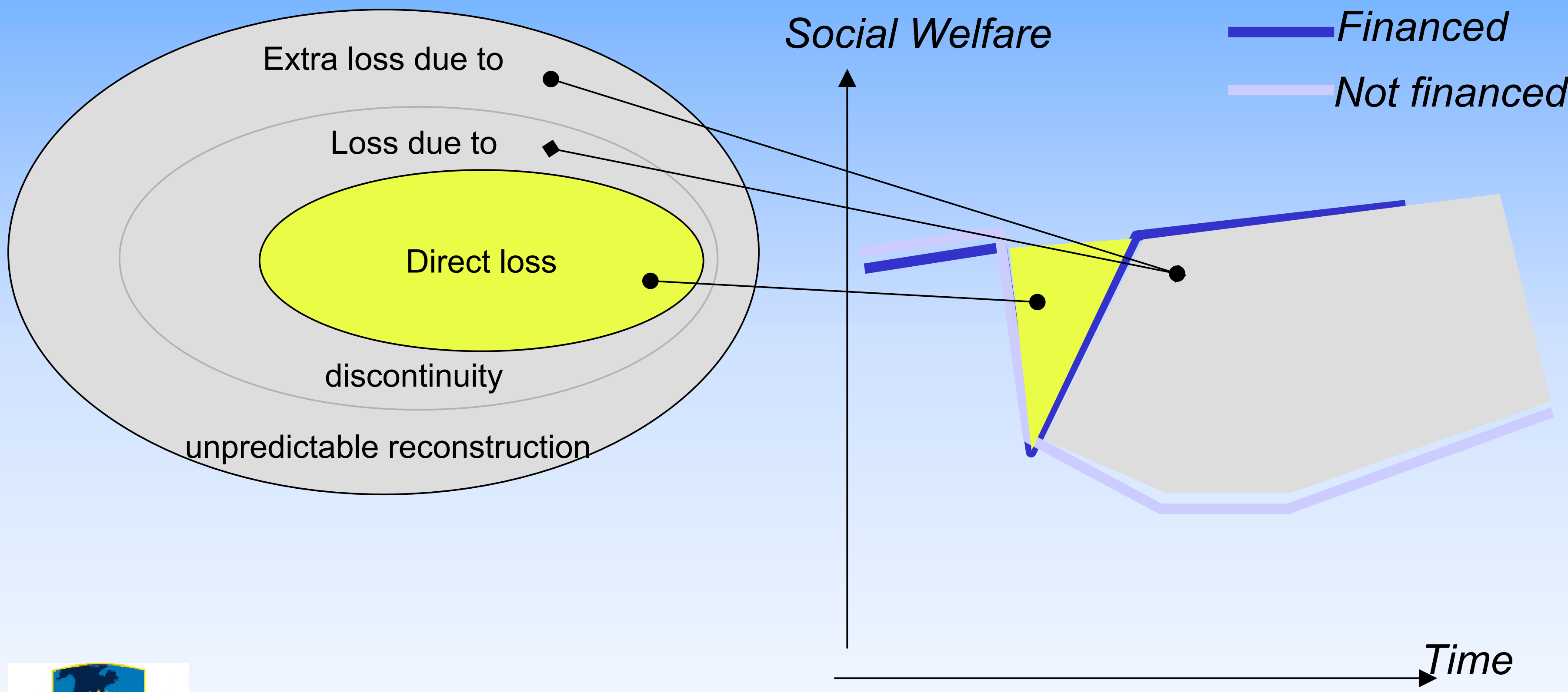
Insured losses per region, 1985-1999		
	Insured losses ($m)	**% of total losses**
North America	116,940	34.45%
Europe	29,990	26.69%
Oceania	4,330	25.71%
Africa	610	8.94%
Asia	17,640	4.30%
LAC	**420**	**3.85%**

Munich Re, Topics 2000: Natural Catastrophes-the Current Position, p.64.

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

The importance of risk financing from a development perspective

Illustration of direct loss and indirect loss due to lack of risk finance



Source: ECON Analysis, 2004

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

Markets for risk financing: El Salvador

Supply side

- Advanced financial and insurance system
- Insurance market has good access to highly rated international re-insurers
- Increases in international reinsurance costs have led to a decrease in coverage
- Insurance industry sources perceive that local insurance companies are able and willing to cover natural disaster risks

Demand side

- The two main obstacles to expand coverage are the low purchasing power of most of the population and a lack of insurance culture and knowledge for covering disaster losses
- Little capability of risks retention because of its reduced size
- Risks retention of the Government is limited by its debt level

Source: Luis Morera, 2004

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

Markets for risk financing: Chile

Demand side

- Insurance coverage available, in what is regarded as the most sophisticated insurance market in the region with over 20 companies including most of the world's largest groups, offering cover

Supply side

- Up to U$ 100 billion worth of public infrastructure is currently not covered by insurance
- Risk financing not a priority in public planning
- Government considers insurance a private activity

Source: Armen Kouyoumdjian, 2004

Markets for risk financing:Peru. Supply vs demand hindrances

Demand side

- Over 60% of the economy is not formal, SME are not insured for Natural Disaster Risk Management.
- Low income people living in marginal areas are taking disaster risks without coverage.
- The damage culture: making money out of emergencies (moral hazard).
- No inventory of state assets under disaster risk. Most public assets are not incorporated to legal registries.

Supply side

- Low enforcement of disaster risk prevention measures by municipalities and housing industry.
- The supply of insurance against natural disasters is insufficient: small farmers, fishery-agriculture.
- Reinsurance premiums are too costly for Peru: lack of historical data.

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

Source: Finanzas Ambientales, 2004

Markets for risk financing:Peru. Supply vs demand hindrances

Demand side

- Peruvian companies do not factor disaster risk into its business plan: it is an extra-cost, so the government ends up paying for it.
- Incomplete coverage of assets in the private sector: limited budget and high premiums.
- Investing in vulnerability reduction is weak. Insurance is not mandatory.

Supply side

- The government is not paying for insurance for the poor people.
- There is no market driven information service on disaster risk.
- Institutional issues: micro-finance and mortgage financing are still limited.

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

Source: Finanzas Ambientales, 2004

Emerging financing mechanisms for low income groups

- Collective insurance
- Parametric insurance
- Micro credits
- Informal credits
- Systems for loans and savings

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO

IDB and the private sector

The Bank assists governments address underlying constraints that hinder the private sector from engaging in risk financing.

- Help remove market barriers to entry,
- Strengthen property valuation and titling,
- Improve the application of building codes, and
- Assist in risk assessments, including support land use planning.

Challenges for improving the involvement of the private sector in disaster risk management

- Integrated management of risk
- Considering prevention as an investment
- Protecting the poor
- Participation of private sector and civil society
- Coordinating international financing
- Resource mobilization from private sources
- Development of financial mechanisms

INTER-AMERICAN DEVELOPMENT BANK
BANCO INTERAMERICANO DE DESARROLLO