Reducing and Managing Disaster Risk through Financial Services
IDB Approach

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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.
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

<table>
<thead>
<tr>
<th>Region</th>
<th>Insured losses ($m)</th>
<th>% of total losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>116,940</td>
<td>34.45%</td>
</tr>
<tr>
<td>Europe</td>
<td>29,990</td>
<td>26.69%</td>
</tr>
<tr>
<td>Oceania</td>
<td>4,330</td>
<td>25.71%</td>
</tr>
<tr>
<td>Africa</td>
<td>610</td>
<td>8.94%</td>
</tr>
<tr>
<td>Asia</td>
<td>17,640</td>
<td>4.30%</td>
</tr>
<tr>
<td>LAC</td>
<td>420</td>
<td>3.85%</td>
</tr>
</tbody>
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Munich Re, Topics 2000: Natural Catastrophes-the Current Position, p.64.
The importance of risk financing from a development perspective

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

Extra loss due to unpredictable reconstruction
Loss due to discontinuity
Direct loss

Social Welfare

Source: ECON Analysis, 2004
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
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.

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.

Source: Finanzas Ambientales, 2004
Emerging financing mechanisms for low income groups

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