Swiss Re

Sovereign insurance –

Creating financial resilience against the growing burden of natural disasters

Climate change, natural disasters and cyber attacks

Climate change, natural disasters and cyber attacks are amongst the most urgent risks on people's minds, according to the latest Global Risk Report published by the World Economic Forum[1]. The last decades have given us regular reminders of the devastation wrought by such risks, and the pressure they exert on local, regional and national governments. People are worried and expect decision makers to take action. We at Swiss Re have developed new insurance solutions to help governments at all levels of administration better manage their fiscal risk by quite simply 'insuring against it'.

The OECD has issued a recommendation on Disaster Risk Financing Strategies[2] stating that effective financial management of disaster risks is a key public policy challenge for governments around the world. Rating agencies are also urging governments at sovereign and sub-sovereign levels to take action to avoid downgrades in the face of climate change. Institutions all over the world have the growing burden of climate change on their agendas.

The message is loud and clear. It's time for governments at all administrative levels – whether national, regional or municipal – to become more hands-on in terms of managing disaster risk. Decision makers need to take bolder steps to make their societies more financially resilient to the impacts of unforeseen events. Swiss Re invites you to engage in a dialogue to explore how insurance can complement your toolbox of fiscal instruments in order to make societies more resilient in the face of these risks.

Sovereign insurance complements the public financing toolbox

Sovereign insurance protects public budgets by providing governments with immediate funds in the aftermath of a disaster. This allows them to take swift action, which helps reduce the longer-term impact on the economy.

Disasters often hit the public budget twice: through higher costs and lower revenues. Reconstruction of public infrastructure, emergency response costs and support for uninsured households lead to higher than anticipated costs. A decline in productivity due to damaged infrastructure or a decline in tourism leads to reduced GDP and a drop in associated tax revenues.

National and international appeals to provide governments with budget support in the aftermath of disasters do exist. But they often come with significant delays,

In Germany, in the last 10 years alone, floods have caused damage of approx. USD 17 billion[3]. Cash-strapped regions and municipalities have been hard put to restore public infrastructure. At the same time, reduced economic activity has led to lower tax revenues.

In Italy, earthquakes like those in L'Aquila, Emilia Romagna and Amatrice have caused economic losses of USD 94 billion since 1970[4]. This puts a huge burden on the public sector, as the popular perception remains that the government will provide relief and reconstruction.

bureaucracy and uncertainty. The criteria and magnitude of these funds are usually only vaguely specified and therefore uncertain. Many national governments have also shifted the financial responsibility for recovery to more subsidiary levels.

New insurance instruments can help: they provide a contractual right to receive funds at the required amount at the required time and stimulate the implementation of a more proactive approach to fiscal risk management, thereby moving from a purely reactive stance to a more conscious level of preparedness.

Acquiring ex-post disaster funding can prove very challenging for regional and local governments but national governments also often struggle to access funds within an acceptable timeframe. Pre-event instruments like sovereign insurance complement the existing toolbox of measures available to governments and public debt managers, such as government bonds, loans, budget reallocation, taxes and aid. Thus insurance increases financial flexibility and further diversifies sources of financing.

Why it matters

People are concerned about climate change and other risks and expect decision makers to act on these risks. The governments taking action will be recognized as pioneers for making their communities more resilient. The governments of Chile, Colombia, Mexico and Peru recently joined forces under the umbrella of the Pacific Alliance and bought sovereign earthquake insurance to protect their budgets. Similar measures have been taken by national and sub-national governments in the US, the Caribbean, several countries in Africa, and China. Overall, the number is still small, but growing.

Once a disaster has occurred, governments are under great pressure to act immediately and find associated funding. Taking precautionary measures helps governments reduce pressure on the public purse after a disaster. It lowers volatility in the state budget and improves planning certainty for the public sector. The quicker an economy can bounce back to normal productivity, the lower the impact will be on society. Very often, financing has proven to be the biggest stumbling block to a quick recovery.

Swiss Re envisages a future in which proactive management of contingent liabilities become an integral part of the annual planning and budgetary process. With Swiss Re, governments can optimise disaster risk financing strategies and reduce costs to society. We look forward to sharing our insights and providing ideas for your solutions for the future.

In Mexico, in 2009, the H1N1 influenza pandemic (swine flu) is estimated to have kept away almost one million overseas visitors, translating into around USD 2.8 billion[5] in tourism losses.

In the first six months after the **Paris** terrorist attacks, the number of visitors to the city declined by one million compared to 2015, and tourism revenues dropped by EUR 750 million.[6]

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Sources:

1 World Economic Forum's Global Risk Report 2018, reports.weforum.org/global-risks-2018/global-risks-landscape-2018/#landscape

2 OECD www.oecd.org/finance/oecd-recommendation-disaster-risk-financing-strategies.htm

3 Swiss Re Institute

4 Swiss Re Institute

5 Rassy D and Smith RD, The economic impact of H1N1 on Mexico's tourist and pork sectors, 2013, www.ncbi.nlm.nih.gov/pubmed/23744805

6 Paris Ile-de-France Comité Régional du Tourisme, 2017, www.thelocal.fr/20170221/ile-de-france-paris-region-loses-1-5-million-tourists-to-terror-fears and www.thelocal.fr/20161111/paris-still-fighting-to-woo-back-tourists-one-year-after-attacks