Swiss Re

Disaster risk financing: how new forms of private-public risk transfer make societies more resilient

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Zurich, 12 June 2008 – The rising impact of natural diasters is driving up the cost of disaster relief and reconstruction for the public sector, especially in developing countries where insurance penetration is still low. Swiss Re's focus report "Disaster risk financing: reducing the burden on public budgets" shows how recent risk transfer solutions offer governments, development banks and relief organisations models to access pre-event financing, and enable them to allocate relief funds more efficiently by using insurance and capital market instruments.

The impact of natural catastrophes on societies has increased considerably over the last two decades, driven by climate change, population growth and expanded economic activity. While average insured catastrophe losses between 1970 and 1989 were USD 8.3 billion per annum, these losses went up to USD 32 billion per annum between1990 and 2007.

At the same time, disasters such as the recent earthquake in China are only rarely insured in many countries. In 2007, a total of 335 natural catastrophes led to overall economic losses of USD 64 billion across the globe, of which USD 40 billion were uninsured. These losses had to be carried by individuals, companies and the public sector.

In countries with less financial resources, a catastrophic event can result in higher deficits and debt for the public sector, which not only shoulders the cost of relief efforts, but is also responsible for rebuilding public infrastructure. In Turkey, for example, an earthquake in 1999 caused an economic loss of 11% of GDP. In 1986, an earthquake in El Salvador cost as much as 37% of GDP.

Shifting from post-event to pre-event financing
"Risk avoidance and mitigation strategies must be the first priority in managing natural disasters. However, no organisation or country can fully insulate itself against extreme events. Transferring catastrophic risk therefore has to be a key element in the financial strategy of every disaster-prone country or region in order to enable and sustain growth," said Reto Schnarwiler, Head of Swiss Re's Public Sector Business Development.

Swiss Re's latest focus report visualises the significant value in shifting the traditional disaster relief approach – raising scarce funds after the event hits – to an approach that accumulates funds and funding sources before a disaster occurs.

Creating a new generation of financial risk transfer solutions
A new generation of sovereign insurance (or "macro-insurance") instruments can make it easier for governments to cope with disasters. Governments will be able to deliver immediate relief to the victims of natural disasters without suddenly creating a significant burden on public finances.

One recent example of this approach is the GlobeCat securitisation programme designed by Swiss Re. Launched in December 2007, this solution uses financial instruments with an innovative trigger mechanism to transfer Central American earthquake risks to the capital markets. GlobeCat provides a payout based on the size of the population affected by a specific earthquake. For example, USD 1 million of donations or government funds can be used to secure contingent disaster relief funds in the amount of USD 45 million.

In parallel, innovative micro-solutions can protect previously uninsured individuals and small enterprises from the catastrophic financial consequences of weather-related risks. Swiss Re's Climate Adaptation Development Programme (CADP), launched in 2007, aims at providing financial protection against drought conditions for up to 400 000 people in Africa. Based on climate risk indices, CADP will contribute towards developing a risk transfer market that will help smallholder farmers in Africa buy agricultural inputs, overcome a lack of collateral, draw upon agricultural extension services and accumulate income.

Partnership in risk transfer and financing
"While governments, development banks or NGOs are constantly getting better at managing disasters more actively, they are finding it more and more difficult to address the financial implications of large-scale natural disasters. New forms of public-private partnerships allow them to leverage their funds through the use of insurance and capital market instruments," said Michel Liès, Member of Swiss Re's Executive Committee.

Notes to editors

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