Swiss Re

Sovereign insurance –

Creating financial resilience against the growing burden of 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,

Tohoku earthquake: The earthquake in 2011 was the most powerful to hit Japan. Claiming 16 000 lives it caused a total economic loss of JPY 25 trillion (USD 310 billion). JPY 17 trillion (3.6% of GDP) has been approved for reconstruction. As part of the "Special Measures to Secure the Financial Resources to Implement the Restoration from the Tohoku Earthquake", a Corporation Surtax was introduced in 2012.[3]

Man-made explosion **in Tianjin:** The explosion in the Port of Tianjin in 2015 rang a warning bell about the importance of managing risks pertaining to hazardous chemicals. This man-made disaster caused 165 deaths and 798 people to be injured. In addition, it destroyed more than 300 buildings, 12 000 cars, and 7 500 shipping containers. The total direct economic loss is estimated to CNY 6.9 billion.[4]

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.[6]

Pandemics **in China:** In 2013, the H7N9 bird flu outbreak in China is estimated to have caused USD 6.5 billion in losses to the economy, also counting the impact on prices, consumer confidence and trade. Authorities shut down live poultry markets temporarily or permanently as needed, in order to control the source of the outbreaks in 10 provinces. 131 people were infected and 36 lost their lives.[5]

Snowstorm **in Kanto region:** Heavy snowfall in the Kanto region caused estimated insured losses of JPY 276 billion (USD 2.5 billion) in 2014. 25 people lost their lives and 951 were injured. Tokyo recorded 27 cm of snow, grounding more than 100 flights and delaying 160 000 train passengers.[6]

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Sources:

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

3 OECD, National Tax Agency of Japan, PwC

4 Xinhua Net

5 China Animal Agriculture Association

6 Disaster Management Bureau, General Insurance Association of Japan