CONCLUSIONS OF THE FIRST CONFERENCE ORGANISED UNDER THE AUSPICES OF THE OECD INTERNATIONAL NETWORK ON THE FINANCIAL MANAGEMENT OF LARGE-SCALE CATASTROPHES

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Session I: Indian Perspective on the Financial Management of Large-Scale Catastrophes

- Natural catastrophes exact a heavy human, social, and economic cost and pose a threat to economic development. In India, risk-based systems of emergency management have been established and risk-based approaches have been integrated into development programs. India can be commended for the progress made, including the creation of the National Disaster Management Authority. But more can be done.

- In particular, governments, regulators, and other groups should work together to address the financial aspects of disaster management and compensation and reduce the fiscal exposures of governments. This requires, among other things:

  - Promoting the expansion of affordable, accessible insurance, through traditional insurance products and micro-insurance.
  - Ensuring that the insurance industry can properly measure and manage risk using modern modelling techniques.
  - Considering possible ex ante pooling arrangements to ensure adequate insurance capacity. It would be wise to review trends and best practices in the financial management of large-scale disasters in developed and other developing countries. A key policy issue is whether to introduce some form of compulsion in these arrangements in the formation of pools.
  - Promoting consumer and industry risk awareness, including possible educational campaigns.
  - Promoting annually disaster mitigation programme for one month prior to onset of monsoons by government, industry and regulators.

Session II: Examination of Catastrophic Risks and Financial Consequences

- The frequency and severity of natural catastrophes has been increasing in recent years. Climate change will increasingly figure on the agenda of discussions on catastrophic risks and, in this respect, there is a need to quantify climate induced risks better and consider solutions for the financial management of these risks. Regional strategies should be developed to cope with expected losses from disasters induced by global warming.

- Modelling techniques and practices have made considerable progress in recent years. A proper technical understanding of the underlying risks (including risk differentials across regions) is a prerequisite for establishing a sound technical basis for institutional/pooling arrangements in countries and making them sustainable in the long-run, but risks are not uniform and models should take this into account.

- In multi-peril risk assessments, different natural hazards may become critical depending on the time period considered (short-term 50 vs long-term 1000 years).

- There is a high demand for accumulation data on large-scale catastrophes and sharing of such data should be encouraged where possible.

- The International Network should develop best practices to deal with the financial management of large-scale risks.

- Catastrophic risk management should be fully integrated in government risk management.

Session III: Part A (Financial Management: Role of Insurance Industry, Financial Markets, and Governments – OECD Countries)

- There are many differences in the operational aspects of ex ante schemes such as their respective approaches to choice of participation, range of perils covered, and method of declaration of catastrophe event. Such differences reflect local requirements and are to be expected and supported. However, there are common operating matters to consider.

- The linkage of insurance and capital markets is an important development which could help the capital and liquidity available for the financial management of large-scale catastrophes. Developments should be monitored and encouraged.

- Approaches to pricing may need to be more pragmatic in insurance schemes than would normally be the case if the schemes are to be sustainable in the long run and be effective. Nevertheless, risk management incentives should be encouraged.

- While governments may be expected to play an important role, especially for mega-risks, it should avoid crowding out of private sector initiatives and/or moral hazard.

- Financial management mechanisms should, as much as possible, favour prevention and risk mitigation.

- Private/public partnerships and a layered approach involving the insured, insurance industry, financial markets and where relevant governments are to be considered. Compulsion of catastrophic risk insurance was viewed as an approach to develop more comprehensive insurance coverage and build national insurance capacity.

- Financial markets are expected, in the future, to help in the diversification of catastrophic risks and may allow the private sector to take on larger risks in the longer run.

Session III: Part B (Financial Management: Role of Insurance Industry, Financial Markets, and Governments – Developing Country Perspective)

- Changes in the social environment have made the urban areas more vulnerable, especially in the developing countries.

- Comprehensive work needs to be done to bridge the gap between economic and insured losses.

- Developing countries need a comprehensive policy framework where attention should be paid to (1) pre-event loss prevention, (2) risk financing, and (3) financial aid after the event of disaster.

There is a need for serious and careful study of allocation of public fund with the role of government in mind, including possible tax incentives for the formation of catastrophe risk reserves and incentive for the building of disaster resilient houses.

- The commitment of political leaders and top-level policymakers is critical. The OECD should promote disaster prevention and ex ante funding arrangements in countries, and promote international and regional cooperative arrangements. Pooling arrangements (at country or regional level) could help in lowering the cost of insurance and providing for immediate access to liquidity.

- International insurance and reinsurance, and capital markets can play an important role in developing countries in building domestic expertise and financial capacity. International insurers and reinsurers should also help developing countries to build quality data bases which are vital to make catastrophe risk modelling effective and useful tool for risk financing.

- To promote risk awareness in catastrophe prone areas is important pre-condition to make risk-based pricing acceptable in those regions and for the development of insurance markets.

- Local and regional initiatives are important as well for the development of insurance capacity, especially in country with high degree of geographical diversity. Recent World Bank efforts should be encouraged.

Session IV: Improving Risk Awareness and Literacy

- The severity of a disaster is determined not only by the severity of the natural hazard itself but also by the vulnerability of the people it affects. Better preparedness reduces the severity of the disaster. For this, risk awareness and literacy are essential to prepare the people in advance.

- Insurance penetration is extremely low in poorer countries which are expected to suffer the most from natural catastrophes.

- Creating risk awareness is a challenge across the world and more so in developing countries. There must be an ongoing programme for creating risk awareness and literacy among the people by various agencies like governments, insurance companies, etc. In India, a positive step has been taken by legislating the National Disaster Management Authority and setting up similar authorities at state level, which will bring about better accountability on the part of the Government.

- Insurance companies have a great role to play in popularizing insurance as an effective tool to mitigate the losses of a disaster. For this they must establish their credibility as fast claim payer.

- Improving risk literacy will positively affect the effectiveness of catastrophe risk insurance. In the case of mandatory insurance schemes, it will ease the problems associated with enforcement. In the case of voluntary schemes, it will help to improve insurance take-up rates.

- Disaster risk awareness needs to start early. School children should be targeted.

- Work on risk awareness and education by the OECD and other international organizations like the UN ISDR should be further encouraged.

Session V: Special Case Study (Pandemics)

- Unlike all other natural catastrophes, it needs to be recognized that a pandemic has unique features in that it is likely to be global, to recur in repeated phases for two or three years, and to have characteristics in infectiousness and mortality that will not be known until an outbreak has started.

- Beyond the issues of medical care, developed country governments have over the past year undertaken significant thinking and contingency planning on how they would cope with a pandemic, in particular with regard to ensuring the continuation of principal services and financial markets. The OECD has a key role to play in bringing different pandemic contingency planners in OECD governments and major private companies to attempt to learn from each others' work, particularly in mitigating the worst economic impacts of a pandemic.

- In addition, little contingency planning around economic impacts appears to have been taken so far in the developing world and it is proposed that the OECD play a role in calling a meeting in which planners in developing countries could be brought to learn from the latest work on contingency planning in developed countries.

- Beyond the life and health area, the role of insurance against pandemics currently appears to be limited. However, there are a number of 'grey areas' about coverage that the insurance industry should be encouraged to resolve before a pandemic leads to large volumes of claims.

- In a pandemic a key issue concerns liquidity of businesses whose activities are interrupted through loss of customers and suppliers, and how banks will respond to situations where these companies will otherwise go out of business. Banks should be encouraged to develop policies to address possibly dramatic short-term losses of revenues of borrowers