DRAFT RECOMMENDATION OF THE COUNCIL ON DISASTER RISK FINANCING STRATEGIES

ONLINE PUBLIC CONSULTATION

DEADLINE FOR COMMENT – 15 APRIL 2016

The draft Recommendation of the Council on Disaster Risk Financing Strategies has been elaborated by the OECD's Insurance and Private Pensions Committee and is being circulated publicly for consultation. It may still be subject to modifications, in particular to reflect, as appropriate, the relevant comments received through the public consultation. We are looking for your comments, suggestions and constructive input so that the final output of this work can be as useful and relevant as possible.

Comments should be sent by 15 April 2016 to leigh.wolfrom@oecd.org. A summary of comments received by that date will be made available to the public unless otherwise requested.

Introduction

The effective financial management of disaster risks is a key public policy challenge for governments around the world, particularly those faced with significant exposures to such risks and/or limited capacity to manage the financial impacts of natural and/or man-made disasters, such as floods, earthquakes, cyclones, terrorist attacks, industrial and technological accidents, and pandemics (amongst others). Fora such as the G20 and the Asia-Pacific Economic Cooperation (APEC) have devoted significant attention to these issues. Substantial guidance and analysis from international organisations such as the OECD, the United Nations and the World Bank on disaster risk management have also been developed.

In 2010, the OECD Council adopted the *Recommendation of the Council on Good Practices for Mitigating and Financing Catastrophic Risks* to provide guidance on the main components of disaster risk management (in particular from the perspective of the financial management of disaster risks). In the context of a review of implementation for the Council, the Insurance and Private Pensions Committee considered that significant updates to this guidance would be necessary to position this legal instrument as the main international guidance on the development of strategies for the financial management of disaster risks. The draft Recommendation of the Council on Disaster Risk Financing Strategies is aimed at replacing the 2010 Recommendation. Once adopted, it would be open for adherence by OECD non-Members.

The draft Recommendation draws on the lessons that have been learned since 2010 through the OECD's work for the G20 and APEC Finance Ministers by placing emphasis on issues that have been challenging to address in OECD Members and non-Members. It is aimed specifically at issues related to the financial management of disaster risks, yet recognises the importance of an integrated approach to disaster risk management and the contribution of risk assessment, risk awareness and risk prevention to the financial management of disaster risks.

DRAFT RECOMMENDATION
ON DISASTER RISK FINANCING STRATEGIES

THE COUNCIL,

HAVING REGARD to Article 5b) of the Convention on the Organisation for the Economic Co-operation and Development of 14 December 1960;

HAVING REGARD to the Recommendation of the Council concerning Guidelines on Earthquake Safety in Schools, the Recommendation of the Council on Good Practices for Enhanced Risk Awareness and Education on Insurance Issues, the Recommendation of the Council on the Protection of Critical Information Infrastructures, and the Recommendation of the Council on Digital Security Risk Management for Economic and Social Prosperity;

CONSIDERING the development of legal instruments providing guidance on the management of disaster risks since the adoption of the Recommendation of the Council on Good Practices for Mitigating and Financing Catastrophic Risks, which this Recommendation replaces, and, in particular, the adoption of the Recommendation of the Council on the Governance of Critical Risks, which provides complementary guidance on the management of critical risks, including disaster risks;

RECOGNISING the significant economic and financial impact of disasters, both natural and man-made, and the potential for climate change to increase the frequency and intensity of extreme events, which combined with increases in the value of assets at risk can be expected to lead to larger impacts in the future;

RECOGNISING that the costs associated with natural and man-made disasters need to be properly assessed and financially managed, and that this requires the proactive development and regular update by governments of integrated disaster risk financing strategies to mitigate the financial and economic impacts of disasters;

RECOGNISING that a disaster risk financing strategy is a central component of a comprehensive approach to disaster risk management and should be anchored in an integrated framework of hazard identification, risk and vulnerability assessment, risk awareness and education, risk management, and disaster response and resilient recovery;

RECOGNISING that risk financing and risk transfer tools, such as (re)insurance and capital markets instruments, can play a fundamental role in reducing the economic impacts of disasters;

NOTING that the OECD plays a leading role in supporting Members and Partners in managing the financial impacts of disasters, and that this work has been welcomed by international fora, such as in the Communiqué of the Meeting of G20 Finance Ministers and Central Bank Governors in Mexico City (2012) and the Asia-Pacific Economic Cooperation Finance Ministerial Meeting's Joint Ministerial Statement (2013);

NOTING that during the meeting of the Council at Ministerial level on 29-30 May 2013, Ministers considered the importance for governments to improve their ability to anticipate and manage complex policy challenges that pose a potential threat to the well-being of citizens and businesses, which includes identifying and managing risks, planning for long-term change and dealing with multi-sectoral issues;

On the proposal of the Insurance and Private Pensions Committee:

I. AGREES that, for the purpose of the present Recommendation, the following definitions are used:

- "Disaster risks": a function of hazard, exposure, vulnerability and capacity, disaster risks are related to the occurrence of sudden onset events which are both natural and man-made (e.g. earthquakes, floods, industrial accidents, terrorist attacks), some of which should be considered critical risks;

- "Financial Protection (Tool)": a financial instrument that provides a payment based on the occurrence of a disaster event and/or the specific costs incurred as a result of a disaster event (e.g. property insurance contract, parametric insurance contract, catastrophe bond, etc.);

- "Public (re)insurance": insurance or reinsurance provided by the public sector;

- "Risk assessment": a methodology to determine the nature and extent of risk by both analysing hazards and their potential likelihood and intensity and estimating impacts through the evaluation of conditions of vulnerability and the identification of exposed people, property, services, livelihoods and their environment;

- "Risk retention": an approach to risk management that involves retaining responsibility for the risk and any costs associated with the occurrence of that risk;

- "Risk transfer": an approach to risk management that involves the transfer of financial responsibility for some or all of the risk and any costs associated with the occurrence of that risk; and

- "Transboundary (impacts)": consequences of risk spilling over national borders, or migrating from one economic sector, administration or community to another, often with differentiated effects.

II. RECOMMENDS that Members and non-Members having adhered to the Recommendation (hereafter "the Adherents") establish a strategy, under the leadership of Ministers of Finance or other relevant national authority, for managing the financial impacts of disasters that:

i. Fosters, by encompassing the elements of this Recommendation, an integrated approach to the financial management of disaster risks across all levels of government, built on a foundation of comprehensive risk assessment and aimed at maximising the overall cost-effectiveness of public and private investment in prevention, financial protection and recovery and reconstruction.

ii. Provides the resources necessary to ensure sufficient institutional capacity and expertise for the assessment of disaster risks and the relative costs and benefits of different approaches to managing those risks as well as sufficient levels of investment in prevention, financial protection and recovery and reconstruction.

iii. Ensures cooperation and coordination across organisations, public and private, with responsibilities for, and expertise in, managing disaster risks.

iv. Where relevant, leverages opportunities for international cooperation and information sharing, recognising the potential transboundary impacts of disaster risks.

v. Assesses the appropriate levels of risk retention and risk transfer, taking into account the responsibilities and accountabilities for disaster risk management across the public and private sectors and their capacity to manage the financial impact of disasters.

vi. Incentivises risk reduction by all stakeholders and the availability of financial protection from private insurance, reinsurance and capital markets.

III. RECOMMENDS that Adherents promote comprehensive risk assessment processes that allow for the estimation of exposures and the identification of financial vulnerabilities by:

i. Promoting the development of technologies and expertise in monitoring and assessing disaster risks by government, the private sector and non-governmental organisations, including the scientific and academic communities and, where beneficial, by taking advantage of private sector capability and expertise in the development of risk assessment and exposure models.

ii. Ensuring that data on assets, structural vulnerabilities, hazards and past losses necessary for the quantification of potential exposures is collected and made available, while respecting commercial confidentiality.

iii. Taking into account both direct and indirect impacts, evaluating both normal and more extreme scenarios, anticipating any significant changes in the nature of risk (*e.g.*, as a result of climate change), and accounting for the level of uncertainty inherent in such estimates as well as regional and international interdependencies.

iv. Completing post-disaster loss assessments for significant events, undertaken based on a consistent methodology, which would support the availability of data necessary for evaluating exposures to disaster risk.

v. Sharing necessary data and information, including on hazards, losses and exposures, as appropriate, and promoting efforts to harmonise the collection of data locally, nationally, regionally and internationally.

IV. RECOMMENDS that Adherents support the management of disaster risks through the use of risk financing tools by all segments of the population and economy by:

i. Supporting initiatives to raise citizens' and businesses' awareness of disaster risks and their responsibility for managing those risks, including through the use of financial protection tools, while taking into account the behavioural biases of individuals and groups, such as the tendency to underestimate risk.

ii. Establishing a financial sector regulatory and supervisory framework that:

   a. Ensures a sound, open and efficient financial sector with sufficient financial capacity to absorb disaster risks, including by enabling the use of risk transfer to national and international reinsurance and capital markets.

   b. Ensures transparency, by communicating in terms that are understandable to non-experts, the scope of financial protection provided by financial institutions and any exclusions, with the aim of building consumer awareness of their level of financial protection and facilitating claim management; and

   c. Ensures that the necessary plans, processes and operational capacity are in place to provide timely and fair payment of claims under financial protection tools.

iii. Addressing challenges to the availability and affordability of financial protection tools for all disaster risks, by considering the use of targeted investments in prevention, financial incentives for the purchase of financial protection or private investment in risk reduction, alternative financial instruments, public (re)insurance and other financial schemes and/or regulatory requirements related to the purchase or offer of financial protection tools. This could include, for example, government means-tested voucher programs that cover portions of the insurance premium and loans for investing in cost-effective risk reduction for the vulnerable population.

iv. Enabling pricing, contractual terms and conditions (e.g. premiums, deductibles, coverage limits, co-share, excess of loss) that promote coverage while encouraging risk reduction.

v. Where applicable, ensuring that government financial assistance, (re)insurance, and guarantees do not reduce the demand for financial protection tools or otherwise crowd-out private (re)insurance supply and capital market financing, and uses private sector capacity wherever possible.

V. RECOMMENDS that Adherents ensure adequate financial support for protecting vulnerable segments of the population and economy and minimising economic and social disruption by:

i. Identifying segments of the population and economy that may be particularly adversely impacted by disaster events, including sub-national levels of government.

ii. Where necessary, developing public compensation and financial assistance arrangements to provide timely, targeted, transparent and equitable assistance for uninsurable losses to vulnerable segments of the population and/or economy and financial transfer mechanisms to provide support to sub-national levels of government facing fiscal constraints.

iii. Minimising the potential for economic disruptions by ensuring plans are in place to facilitate the timely disbursement of funding and a stable supply of financing to the economy.

iv. Ensuring that the provision of such assistance is coordinated across all levels of government and does not discourage private or public risk reduction or the demand for financial protection tools.

VI. RECOMMENDS that Adherents manage government exposures to disaster risks by:

i. Evaluating the potential financial exposures of government to disaster risks, taking into account, where applicable:

a. The expected costs of relief and recovery as well as reconstruction of public infrastructure;

b. Exposures to insured losses as a result of public (re)insurance or other financial schemes;

c. Estimated payments under public compensation and financial assistance arrangements to segments of society and the economy that are vulnerable to disaster risks and/or sub-national levels of government, including the possibility of unanticipated financial assistance (*e.g.*, unplanned assistance as a result of insufficient financial capacity among sub-national levels of government, financial institutions or particular segments of society); and

d. The potential impact of a deterioration in macro-economic conditions, such as a decline in economic activity, government revenues or a deterioration in the balance of payments.

ii. Developing a plan for the financial management of government exposures (using financial tools such as budget reallocations, temporary taxation, debt financing, reserves, insurance, capital market instruments) that takes into account financial capacity, desired risk retention and transfer levels, as well as the cost, timing and availability of the various financing options and the benefit of risk retention or risk transfer relative to investments in risk prevention.

VII. INVITES the Secretary-General to disseminate this Recommendation;

VIII. INVITES Adherents to disseminate this Recommendation at all levels of government;

IX. INVITES non-Adherents to take into account and adhere to this Recommendation;

X. INSTRUCTS the Insurance and Private Pensions Committee to monitor the implementation of this Recommendation and to report thereon to the Council no later than five years from its adoption and regularly thereafter.