

INSURANCE MECHANISM AND THE FUNDING OF POST-DISASTER RELIEF

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INSURANCE MECHANISM AND THE FUNDING OF POST-DISASTER RELIEF

Themes for Discussion

Theme I: The Financial Fallout of Disaster

- Theme II: Third Party Funding & the Insurance Angle
- Theme III: The Pre-requisites
- Theme IV: The Destination

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The Financial Fallout of Disaster

Disaster Management: Different Approaches

- **Ex-post approaches:**
 - mitigation,
 - response,
 - relief,
 - rehabilitation and
 - expenditure on all these activities
- **Ex-ante approaches:**
 - disaster prevention,
 - planning to face consequences of disaster
 - preparation to mitigate consequences of disaster
 - provide funds for rolling matters to normal & related activity

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The Financial Fallout of Disaster

The Problem:

- In developing countries, a large part of the large scale funding required post-disaster, for:
 - relief,
 - rehabilitation,
 - restoration of infrastructure
- Are actually being met by the government by:
 - reprioritizing planned budgets,
 - increasing tax & borrowings.

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The Financial Fallout of Disaster

The Problem:

Ex-ante, Governments cannot:

- anticipate costs of post-disaster funding & make adequate provisions.
- stack up huge amounts of money for uncertain contingencies.
- neglect more tangible & current requirements of the economy.

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The Financial Fallout of Disaster

The Problem:

Ex-post, Governments, have to practically arrange for funds by:

- utilizing funds earmarked for other activities, mostly development activity and
- throwing financial planning out of gear.

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Themes for Discussion

- Theme I: The Financial Fallout of Disaster
- **Theme II: Third Party Funding & the Insurance Angle**
- Theme III: The Pre-requisites
- Theme IV: The Destination

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Third Party Funding & the Insurance Angle

- **Developed Country Context:**
 - Insurance is integral to the system
 - Most relief programs require insurance to be exhausted before providing any financial relief.
 - Disaster claim payouts by insurers routinely exceed Federal payments in the USA.

The funding sequence –

- i. Affected party's insurer,
- ii. Humanitarian relief agencies,
- iii. The Government.

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Third Party Funding & the Insurance Angle

How does Insurance takeover:

- Insurers cover costs of disaster recovery/restoration by spreading the risks over a large number of insured.
- Insurers thus reduce the financial impact of disaster on insured victims & local governments.
- Thus, the Government becomes a source of residual funding beyond the layers of funds that insurers and all other agencies provide.
- Popularizing insurance as a means of funding the cost of disaster is a matter of serious concern for the Government.

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Third Party Funding & the Insurance Angle

- **Only less than 25% of all the disaster losses are covered under insurance - UN study of 2005.**
- **Out of a total economic cost of US\$ 225bn imposed by disasters, 36% (around US\$ 80bn) was insured - Swiss Re study of 2005.**
- **Insured losses in developing countries average just about 5-10% of the total disaster costs**
- **The USA and Europe have much higher insurance coverages.**

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- Theme II: Third Party Funding & the Insurance Angle
- **Theme III: The Pre-requisites**
- Theme IV: The Destination

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The Pre-requisites

Reasons of Low Insurance Coverage:

- Low insurance awareness,
- Unavailability of the right insurance cover,
- Premiums beyond one's ability/ willingness to pay and
- Lack of faith that insurer will pay when disaster strikes.
- Lack of purchasing power,
- Lack of interest in insurance,
- Theory of *karma* attitude and
- Ignorance of availability of Insurance covers.

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The Pre-requisites

Reasons of Low Insurance Coverage:

- **Viability of an insurance fund, in which the premium is paid fully or substantially by the Central or State Governments appears not viable**
- **It may not reduce the financial burden on the Government as compared to a fund created at the Government level for meeting expenditure on calamity relief.**

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INSURANCE MECHANISM AND THE FUNDING OF POST-DISASTER RELIEF Third Party Funding & the Insurance Angle

Date	Event	Location	Fatalities	2004 Rank		Insurance %
				Economic Losses	Insured Costs	
23-30 Aug. 2005	Hurricane Katrina	US	2,541	\$81.2 billion	\$41 billion	50.5%
15-29 Sept. 2004	Hurricane Jeanne	Haiti, Dominican Republic	2,000	Rank 7- \$6.6 bn	Rank 4-\$4.5bn	68%
7-21 Sept. 2004	Hurricane Ivan	US, Caribbean		Rank 3- \$20 bn	Rank 1-\$11.7bn	58.5%
1-9 Sept. 2004	Hurricane Frances	US, Caribbean		Rank 5- \$8.4 bn	Rank 3-\$4.7 bn	56%
6-8 Sept. 2004	Typhoon Songda	Japan, South Korea		Rank 8- \$6.0 bn	Rank 5- \$3.0 bn	50%
19-21 Oct. 2004	Typhoon Tokage	Japan		Rank 10- \$2.5bn	Rank 6- \$1.1 bn	44%
11-14 Aug. 2004	Hurricane Charley	US, Caribbean		Rank 2- \$21.3bn	Rank 2-\$7.6 bn	36%
23 Oct 2004	Earthquake	Japan		Rank 1- \$28 bn	Rank 10- \$450m	1.6%
26 Dec. 2004	Tsunami	Indonesia, Sri Lanka, India	40,000	2004 Rank 4- \$10 bn	"in the low single-digit billions,"	Low 10%

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The Pre-requisites

Reasons of Low Insurance Coverage:

- **The problem can thus be crystallized as follows.**
- **In order to fund the cost of disaster, the Government needs alternate mechanisms.**
- **Insurance has been found a viable alternate funding mechanism elsewhere in the world.**
- **Governments paying the entire insurance premium may not be cost effective as well.**
- **The solution that emerges is that if a good number of private entities purchase insurance, insurance can be a dependable mechanism for reducing the Government's burden of funding the cost of disaster.**

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The Pre-requisites

Reasons of Low Insurance Coverage:

The Challenge: Getting the solution implemented

- **Insurers are in the business of**
 - **taking risk,**
 - **spreading risk and**
 - **mitigating risk; and**
 - **logically should not be averse to taking the risk of Indian disasters as well.**

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The Pre-requisites

Reasons of Low Insurance Coverage:

The Challenge: Getting the solution implemented
Consumers of insurance also would not be averse to the idea of someone else funding the cost of their disaster.

- **What are the main concerns for the sellers of insurance?**
- **What are the main concerns for the buyers of insurance?**
- **What are the pre-requirements for the insurance mechanism to function effectively enough and take over a substantial part of post-disaster funding from the government?**

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The Pre-requisites

The Concerns: Sellers of Insurance

- ❖ **Once insurance is sold, the risk of funding post-disaster costs gets transferred to them;**
- ❖ **Insurers, or anybody in business, cannot afford to fund the cost of disaster relief on their own.**
- ❖ **Insurance system works on the premise of the loss of a few being shared/ subsidized by many others.**
- ❖ **Insurers have to identify homogenous groups.**
- ❖ **Insurers work on a complex set of probabilities over a large group of similarly placed risks, estimate the frequencies and severities of possible disasters from past data and provide funds for anticipated costs of disaster.**

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The Pre-requisites

The Concerns: Sellers of Insurance

- ❖ Insurers' funds come from the premiums collected from many insured in diverse geographical locations, all of who may not be affected by disaster at the same time.
- ❖ If the expected effect of disaster is more than what insurers can spread over their various groups of insured at different geographical areas, over a reasonable period of time; they would have to reinsure the risks so that the expected cost of disaster is spread across multiple groups of risks insured with insurers across multiple countries, and over multiple periods of time.

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The Pre-requisites

The Concerns: Sellers of Insurance

- ❖ Insurers' ability to deal with the disaster depends on the accuracy of the probabilities estimated.
- ❖ The probabilities, depend on scientific risk assessment based on credible data on frequencies, severities & costs of disasters in the past.
- ❖ Credible data is vital to insurers for accepting risk.
- ❖ The Government should be able to provide insurers with credible data on the proposed risk and on similarly placed risks elsewhere in the country.

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❖ Insurers would have to get comparable data from

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The Pre-requisites

The Concerns: Buyers of Insurance

- ❖ Not aware how insurance works.
 - ❖ Premiums are paid for transferring the risk
 - ❖ No money-back system in an event free year.
 - ❖ Lack of trust in the insurance system.
 - ❖ Skeptical whether insurer will pay claims.
- ❖ Those who understand insurance may not like to pay
 - ❖ Do not perceive the risk worth paying for.
- ❖ Those who feel the need, may not have the ability and willingness to pay.
- ❖ Ironically, many of the people who really need insurance cannot afford to buy it.

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The Pre-requisites

The Concerns: Buyers of Insurance

- ❖ Traditional insurers have not served poor households due to two reasons;
 - (1) **Product design issues** like high transaction costs, irregular income flows, difficulties in controlling moral hazard and adverse selection on one side and
 - (2) **Policyholder issues** like affordability, households having limited understanding of insurance, a bias against insurers. Microfinance providers also have their set of woes viz. to achieve scale, to collect data, to develop skills for actuarial analysis, reinsurance, investment and regulation.

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The Pre-requisites

The Concerns: Buyers of Insurance

- ❖ Risk Management includes
 - ❖ risk identification,
 - ❖ risk reduction,
 - ❖ risk transfer/ sharing –
 - ❖ protecting investments and sharing the costs.
- ❖ Risk transfer through insurance is a powerful tool in helping the poor especially in rural economies
- ❖ Not been enough explored in India.
- ❖ The country is yet to move from ex-post financing to ex-ante risk management
 - ❖ Yet to transfer a portion of post disaster financing (recovery and reconstruction) to insurers.

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The Pre-requisites

India: Some Concerns & Some Suggestions

- ❖ The public mindset – to rely on the Government's social commitment than to assume responsibility,
- ❖ Lack of an elaborate social security system,
- ❖ Factors like poverty, illiteracy, vulnerability profile of population,
- ❖ Ignorance of modalities of insurance and lack of trust in capacity and willingness of insurers to pay claims,
- ❖ High cost loan-recovery/ practicality of writing-off loans,
- ❖ Scientific linkages among costs of assets, costs of insurance, recovery costs and Government support yet to evolve.

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The Pre-requisites

India: Some Concerns & Some Suggestions

- ❑ Insurers yet to evolve a commercial approach in addition to the present approach of social obligation
- ❑ More need-based products - affordable, simple, practical to implement & inexpensive to administer to be designed.
- ❑ Concerns like debt repaying capacity, day-to-day expenses to be addressed.
- ❑ Premium and benefits based on simple indices/ tables with regional/ social/ economic variants to be evolved.
- ❑ Insurers are yet to focus on concept selling/getting people comfortable with insurance and creating a future market.

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The Pre-requisites

India Positives

- ✓ India has made a great beginning towards disaster mitigation through micro-insurance.
- ✓ The environment is forward-looking and
- ✓ Multiple stakeholders are involved.
- ✓ RBI's attempts on financial inclusion
- ✓ IRDA's regulatory & development role - defining the concept, approving products, intermediary network etc.

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The Pre-requisites

India Positives

- ✓ NABARD, 57 PSU & Private Banks, 177 Regional Rural Banks, around 400 Co-op. Banks, SHGs, MFIs, NGOs, Agents involved in funding and/or distribution/ support
- ✓ Life Insurers offer 24 micro-insurance products.
- ✓ General Insurers offer multiple products covering personal accident, health, crop, cattle, poultry, bee-hives, pedal cycles etc. (An ILO study of 2004, listed 80 insurance products for disadvantaged groups in India.)
- ✓ Micro-Insurance Education and Support Institutions

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The Pre-requisites

India Positives

- ✓ Public interest - Solution Exchange & other forums
- ✓ State Governments' support to NGOs/ MFIs/ SHGs reaching out to rural areas.
- ✓ Post-earthquake efforts of Gujarat publicizing/ obtaining insurance for socially weaker segments. Efforts to charge a levy on property tax to buy insurance
- ✓ Co-operative societies' efforts to collect insurance premium
- ✓ Efforts of Banks/ Governmental Authorities in making insurance compulsory in some areas.

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The Pre-requisites

Another Positive Indication

- ✓ The renewed commitment of the global insurance industry to deal with climate risks.
- ✓ The "Kyoto Statement of the Geneva Association"
 - ✓ signed by around 70 insurance and reinsurance companies across the world,
 - ✓ declares that insurers "encourage political processes to work towards a better understanding of the potential costs of climate change and the advantage of market based solutions."
- ✓ Declares Insurers' willingness to "play a major and concerted role in the global efforts to counter climate risks."

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The Pre-requisites

Another Positive Indication

- ✓ The Kyoto Statement emphasizes the need
 - ✓ for a structure of sustainable, market-friendly incentives for climate risk adaptation/mitigation
 - ✓ for insurers (whose core expertise is managing the balance between risk exposure and financial stability), to suggest how do this effectively.
- ✓ The statement urges policy makers
 - ✓ to collect robust data and make it freely available
 - ✓ to allow risk assessment and
 - ✓ to facilitate premiums that are risk-based.
- ✓ The need of communicating the financial benefits of risk mitigation and adaptation to customers.

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The Destination

- Possible financial effects of disaster on a rural household due to flood.
- Loss of life,
- damages to one's house,
- loss of house contents,
- loss of cattle,
- loss of cultivation,
- loss of poultry,
- loss of means of livelihood and
- loss of expenses on clothes, medical treatment etc.

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The Destination

- **National Commission for Enterprises in the Unorganized Sector (2007)** - 77% of Indians, lived on less than 20 rupees per day.
- Around 3% are employed in government/ organized public/ private sector.
- This 3% might buy their own insurance protection.
- 27.5% of Indians lived below the national poverty line.
- The remaining 20% can buy limited insurance protection - may be less than their actual insurance needs.
- Micro-insurance & limited protection schemes can bring better protection within their reach.
- However, the 77% low-income and unemployed remain to be the most vulnerable segment to natural disasters.

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The Destination

- **Ideal:** All affected by disaster should be compensated.
- **Practical:** Insurance cannot do miracles. The targets should be realistic
 - simple low-cost insurance products
 - small sums insured
 - giving a set of fixed benefits covering
 - (a) loss of life,
 - (b) loss of house,
 - (c) loss of house-contents,
 - (d) loan/ debt relief on the bread-winner's demise.

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The Destination

- Like Universal Health Insurance Policies
- some limited compensation to the victims within a reasonable time.
- insurers to assume risk and spread it over large groups
- design different products
 - for different situations of vulnerability,
 - paying capacity and
 - needs of compensation.

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The Destination

- The Government has to possibly figure out how to provide the source of funds for purchasing insurance protection for those who cannot afford it.
- The greater challenge for the Government is to propagate the concept of insurance to all people
- increase awareness on different insurance schemes
- improve people's confidence in the insurance system.
- In essence, the Government should create the right business environment so that both insurers and insured are assured of a win-win situation.

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