The Fundamentals of DRF and Financial Instruments

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Abstract

- Recap four core principles of Disaster Risk Finance
- Overview of financing instruments available to governments
- Introduction to advantages and disadvantages of different financing instruments.

What is Disaster Risk Finance?

Protecting livelihoods and development by implementing sustainable and cost-effective financial protection policies and instruments.

- ✓ Ensuring money reaches people who need it the most, when they need it the most
- ✓ Using Financial Planning to protect Investments in human development and productive assets
- ✗ Adapting to long-term climate changes and trends
- ✓ Planning on how to meet the cost of disasters before they happen
- ✓ Increasing the speed, predictability and transparency of disaster response
- ✗ Raising funds from International partners after a disaster
- ✗ Financing risk reduction and development

Four Primary Groups impacted by natural disasters and climate risk

GOVERNMENT

HOME/BUSINESS OWNERS

FARMERS/HERDERS

THE POOREST

Five Steps

Towards Strengthening Financial Resilience

1. Take Stock of how disaster response is currently financed
2. Gather risk information/carry out risk assessments
3. Decide on policy priorities
4. Build financial protection strategy
5. Work with and improve existing processes for DRF

Remember Four Core Principles of DRF

Timeliness of Funding

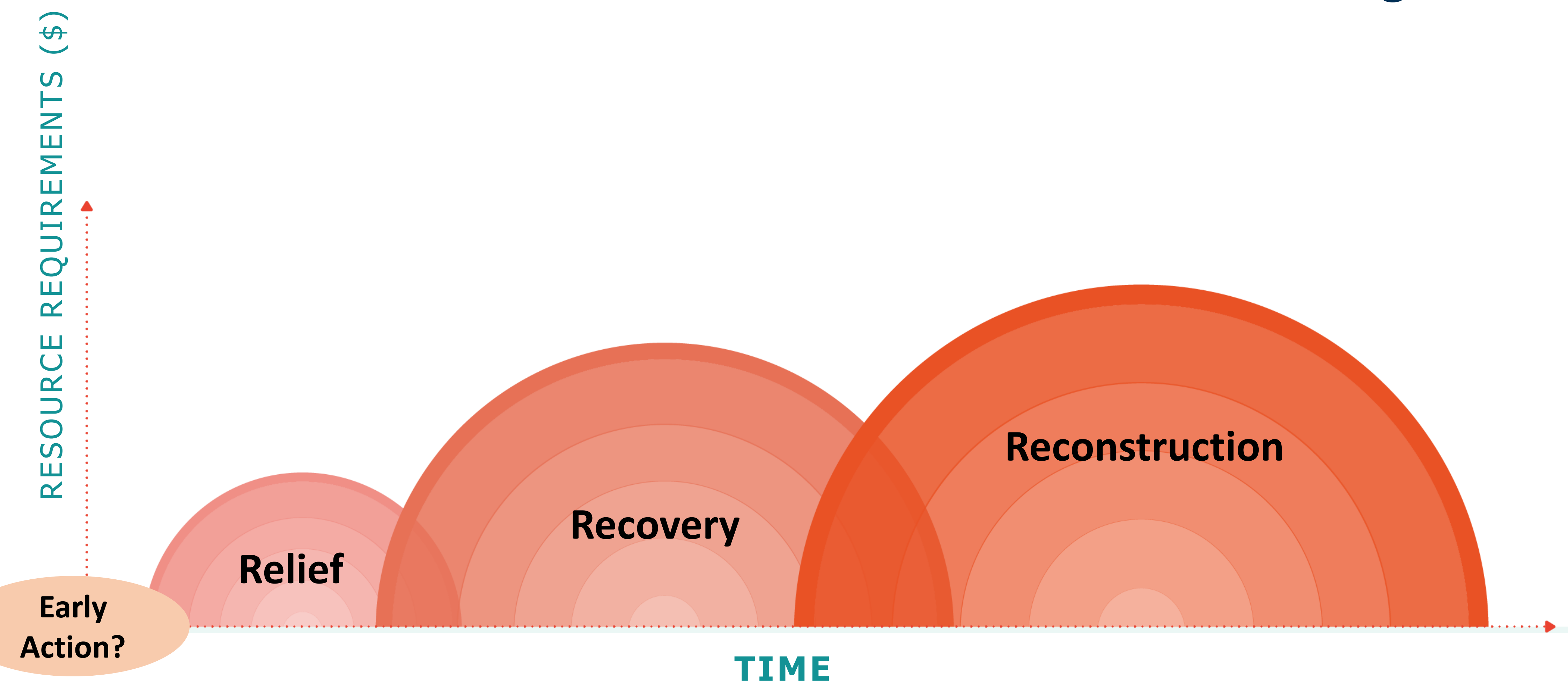
No One Financial Instrument Can Address All Risks

How **money reaches beneficiaries is as important** as where it comes from

To make sound financial decisions **you need to have the right information**

Core Principle 1

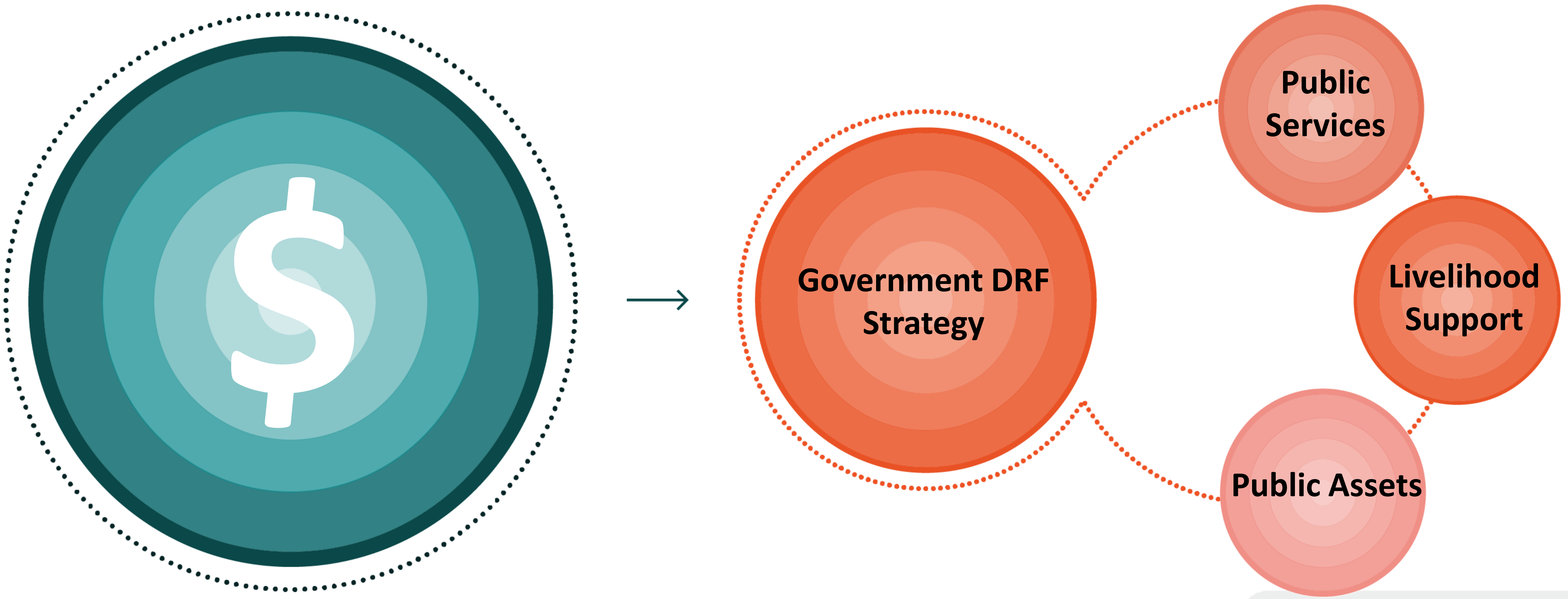
Timeliness of funding



Speed matters, but not all resources are needed at once.

Core Principle 2

How money reaches beneficiaries is as important as where it comes from



Core Principle 3

Disaster Risk Layering

HAZARD TYPE	FINANCING INSTRUMENT		
High Frequency/ **Low** Frequency/ **High** Severity	Market-Based Instruments	**Risk Transfer**	Risk transfer for assets such as property insurance or agricultural insurance and risk transfer for budget management like paramedic insurance, cat bonds/swaps
	Contingent Financing	**Contingent Credit**	Financial instruments that provide liquidity immediately after a shock
High Frequency/ **Low** Severity	Budgetary Instruments	**Budget Reserves/ Reallocations**	Reserve funds specifically designated for financing disaster related expenditures, general contingency budgets, or diverted spending from other programs

International Assistance (uncertain)

No single Financial instrument can address all risks

Core Principle 4

Data and Analytics

Loss Data (Historical Data/CAT Risk Model

Microeconomic Data

Financial and other Data

DRFI ANALYTICS

Quantitative Analytics

Financial Decision Making Tools

Financial Impact Analysis

Cost Benefit Analysis

Understanding Financial Impact of Disasters

Make evidence based financial decisions

Leverage private financial markets using quantitative outputs

Monitor and evaluate DFRI strategies

To Make Sound Financial Decisions you need to have the right information

Common instruments used for financial planning

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Emergency budget reallocation Emergency tax increase Post-disaster Credit
Risk transfer (removing risk from the balance sheet)	Traditional insurance/reinsurance Index insurance, reinsurance, or derivatives Capital market instruments	Discretionary post-disaster relief from development partners

Ex-post transfer

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Emergency budget reallocation Emergency tax increase Post-disaster Credit
Risk transfer (removing risk from the balance sheet)	Traditional insurance/reinsurance Index insurance, reinsurance, or derivatives Capital market instruments	Discretionary post-disaster relief from development partners

Examples:

- Humanitarian aid
- Crisis response grants/loans from development banks

Advantages

- Flexible – can respond to need
- Accurate (?)
- Can be concessional/ grant

Disadvantages

- Can be slow and costly
- Can be unreliable and unpredictable
- Undermines planning

Ex-post retention

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Emergency budget reallocation Emergency tax increase Post-disaster Credit
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Examples:

- Emergency budget reallocation
- Emergency tax increase
- Post-disaster Credit

Advantages

- Can be cheap (but not always)

Disadvantages

- Often slow
- Can be unreliable
- Can have high economic costs / negatively affect other investments
- Undermines planning

Ex-ante retention

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Emergency budget reallocation Emergency tax increase Post-disaster Credit
Risk transfer (removing risk from the balance sheet)	Traditional insurance/reinsurance Index insurance, reinsurance, or derivatives Capital market instruments	Discretionary post-disaster relief from development partners

Examples:

- Contingency fund or budget allocation
- Line of contingent credit

Advantages

- Can be cheap, particularly for frequent shocks
- Fast
- Allows implementers to plan
- Can support clarity of risk ownership

Disadvantages

- Opportunity cost of funds
- Requires fiscal discipline
- Political pressure

Ex-ante transfer

	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
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Examples:

- Traditional insurance/reinsurance
- Index insurance, reinsurance, or derivatives
- Capital market instruments

Advantages

- Can be cheap, especially for extreme shocks
- Can be fast
- Allows implementers to plan
- Supports fiscal discipline

Disadvantages

- Can be expensive for frequent shocks
- Often criticized after the fact
- Can miss need
- Need a level playing field to negotiate

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Disaster Risk Financing & Insurance Program
SUPPORTED BY WORLD BANK GROUP

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GFDRR
Global Facility for Disaster Reduction and Recovery

UKaid
from the British people