Philippines Parametric Catastrophe Risk Insurance Program

Effective July 2017

FREQUENTLY ASKED QUESTIONS

Disaster Risk Financing
& Insurance Program

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“Unlike the traditional indemnity insurance that takes a long time to assess and process, this Parametric Insurance Pilot will have quick-disbursing payouts whose amounts will depend on the estimated loss triggers determined through the Philippines’ Catastrophic Risk Model developed by the DOF [Department of Finance] in 2014.” “This is one of the many efforts of the Duterte administration in making the country disaster resilient and sustainable... Since the Bureau of Treasury is the policyholder, the funds will be mobilized faster for the first responders, namely, the national government and the LGUs [Local Government Units].”

– Paola Alvarez,
Assistant Secretary
Department of Finance, Philippines

"This new insurance program illustrates how the World Bank Group can leverage capital from the market to help governments receive fast cash injections for emergency response and to sustain essential services in times of crisis, empowering local governments to more effectively assist their citizens"

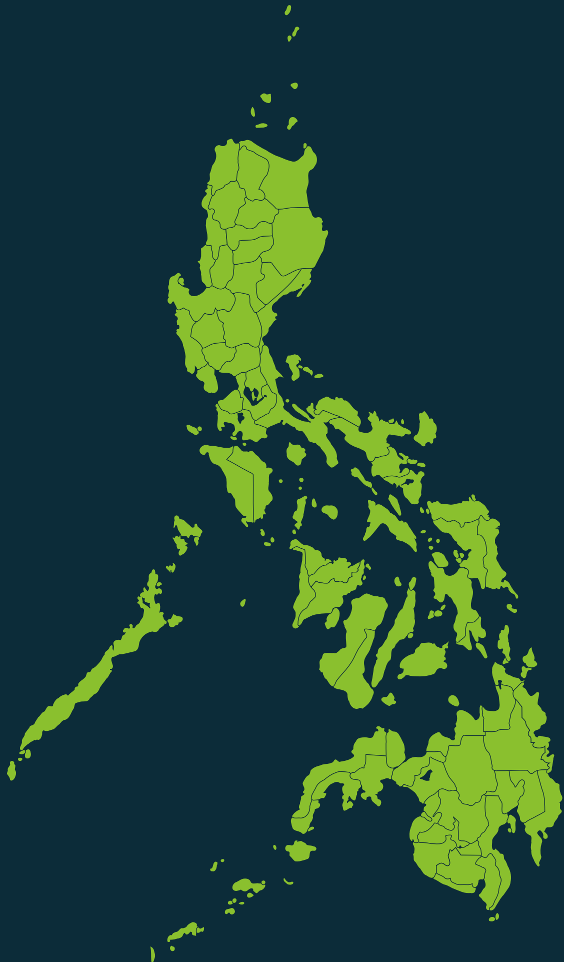
– Joaquim Levy,
Managing Director and Chief Financial Officer
The World Bank Group

Since 1990,
the Philippines has been affected by

565
natural disasters which have claimed the lives of nearly

70,000
people and caused an estimated

US$23
billion in damages.



Typhoon Yolanda in 2013, was one of the strongest typhoons to ever make landfall. It killed

6,200
people, leaving another

1,700
missing and cost the country an estimated

PHP11
billion[1] in damage and economic losses.

it is estimated that the Northwest Pacific basin in which the Philippines lies is hit by

27

typhoons each year, and the Philippines has experienced about

8,000

earthquakes with magnitude 5.0 or greater since the 16th century

1 Government of the Philippines. 2013. Reconstruction Assistance on Yolanda

In July 2017 the Philippines launched a new catastrophe risk insurance program to protect national and provincial government agencies against the financial losses from severe natural disasters.

Catastrophe Risk Insurance Program: Key Facts

Currency

Philippine PESO

Risks Covered

Typhoon, Earthquake

Insurer

Government Service Insurance System (GSIS)

Policyholder

Philippines Bureau of the Treasury

Beneficiaries

50% for national government agencies
50% for provincial governments of 25 select provinces

Total Coverage

Php10.4 billion (equivalent to US$206 million at execution date)

Payout Structure

Payout amounts are pre-defined and trigger based on physical event parameters

Policy Term

One year (July 28, 2017, to July 27 2018)

This insurance program is part of the government's overall disaster risk finance strategy, which seeks to strengthen national and local capacity to respond immediately and effectively to natural disasters. It provides the last line of defense against severe natural disasters and complements other funding sources that protect against less severe natural disasters.

Other financial protection mechanisms already in place include the Disaster Risk Reduction and Management (DRRM) Funds at the national and local level funded from the national budget and the World Bank Second Development Policy Loan with a Catastrophe-Deferred Drawdown Option (CAT-DDO2), which provides US$500 million of standby financing.

Under this program, the government-owned insurance agency Government Service Insurance System (GSIS) will provide catastrophe risk insurance to the national government and the participating provinces.

The World Bank acts as an intermediary to transfer GSIS's risk to a panel of international reinsurers, which were selected through a competitive bidding process.

This program is an innovative example of new solutions that several global initiatives are looking to scale up as a way to improve risk finance and insurance instruments.

What is parametric catastrophe risk insurance? How does it differ from traditional (indemnity) insurance?

Parametric insurance makes a specified payment upon the occurrence of a triggering event satisfying pre-agreed characteristics. It differs from traditional (indemnity-based) insurance that makes a payment based on the actual loss. The payment of claims is based on parametric "triggers," such as specified characteristics of the hazard event covered by the insurance (e.g., earthquake magnitude or typhoon intensity) in specified locations.

Since the payment of claims depends on parametric triggers, and not on actual losses (which would take time to assess in the field), claims can be paid much faster, usually within two to four weeks compared to several weeks or months for traditional insurance. However, unlike traditional insurance, the payout may not perfectly match the actual damage experienced (this potential mismatch is known as basis risk).

How will this program benefit the Philippine national and provincial governments?

This program provides typhoon and earthquake cover to national government agencies and provides typhoon cover to 25 individual provinces. The program aims to provide immediate liquidity after severe typhoon and earthquake events, supporting rapid response and recovery.

Frequent, less severe events can be managed using the national or local DRRM Funds or contingent credit lines.

The program does not aim to cover total damages and losses but rather provide immediate funds until additional resources become available. This approach will allow the national government agencies and provincial governments to better support emergency response and maintain essential government services.




Which provinces are covered by the program?

The 25 Provinces under this program were selected by the government of the Philippines following an assessment of their exposure to typhoon and earth-quake risk based on the Philippines catastrophe risk model developed by the Department of Finance with the technical support of AIR Worldwide.

The provinces include Albay, Aurora, Batanes, Cagayan, Camarines Norte, Camarines Sur, Catanduanes, Cebu, Davao del Sur, Davao Oriental, Dinagat Islands, Eastern Samar, Ilocos Norte, Ilocos Sur, Isabela, Laguna, Leyte, Northern Samar, Pampanga, Quezon, Rizal, Sorsogon, Surigao del Norte, Surigao del Sur, and Zambales.

How much will the national government pay for the program? And to whom?

The total premium paid for this program was PHP 1 billion.

The premium was financed under the 2017 Budget (the 2017 General Appropriations Act , RA 10924), as a Special Provision of the National DRRM Fund appropriation. This Special Provision earmarks PHP1 billion for government facilities' insurance coverage against natural calamities.

The premium was paid by the policyholder, Bureau of Treasury, to the insurer GSIS. The World Bank reinsured the risk from GSIS and in turn passed the risk to international reinsurance markets.

What institutional arrangements govern the program?

A Joint Memorandum Circular No. 2017-1 (the 'Issuance') was drafted in 2017, between the Department of Finance and the Department of Budget and Management, and sets out guidelines for the implementation, monitoring, and reporting on the use of the insurance premium allocation and any potential insurance payouts.

A technical working group was formed to draft the Issuance, led by the Department of Finance and consisting of the Department of Budget and Management, GSIS, Office of Civic Defense, National Economic and Development Authority, and Department of the Interior and Local Government with Commission on Audit, Bureau of Treasury and the World Bank providing technical inputs. The signed Issuance was a crucial document that enabled the Department of Budget and Management and Bureau of Treasury to remit the funds for premium payment to GSIS.

How will the payout be triggered? And how fast can the national and provincial governments get the money?

When a disaster occurs, the catastrophe risk model will calculate an estimated loss amount. If this loss amount exceeds a pre-determined level - or trigger point - it will lead to a payout. The program has two trigger points: one for medium events and one for severe events (defined with a 10% and 3.3% probability of occurrence)

National and provincial governments can get payouts as follows:

Upon occurrence of an event, GSIS will issue a notice to the World Bank that an event has occurred. The World Bank will request the calculation agent AIR Worldwide to determine if any payouts are due.

Within 10 days, AIR Worldwide will determine if any payouts are due based on the pre-determined trigger points and the actual event parameters (e.g., intensity and location of event).

Within 19 days, the payouts will be released by the reinsurers to the World Bank and within 21 days released to GSIS.

Within 24 days, the payouts will be received by the Bureau of Treasury (as policyholder) from the insurer GSIS as per the insurance contract.

The allocation of payouts will be determined by a technical working group and released to national and provincial governments within 29 days.

How will the allocation of payout proceeds be determined? And how can the proceeds be used?

Allocation of payouts to provincial governments is pre-determined based on the insurance contract parameters. Allocation of payouts to national government agencies will be determined by the technical working group based on rapid disaster assessments prepared by the Office of Civil Defense (OCD).

Proceeds are intended to be used solely for post-disaster recovery and rehabilitation activities relating to government infrastructure, and facilities needed to restore operations and immediate delivery of basic services. The use of proceeds by national government agencies will be monitored by the technical working group, while the relevant Regional Project Monitoring and Evaluation Team of the OCD Regional Office shall monitor the use of proceeds by the provincial governments.

Will this be a one-time program? How will the Philippines sustain this insurance?

This program is the first of its kind in the Philippines. It provides cover for severe and extreme earthquake and typhoon events (comparable to Typhoon Yolanda in 2013) over a one-year period. The policy can make multiple payouts within this one-year period, and therefore could provide payouts for multiple events within a year.

This program was the first step towards establishing a dedicated disaster risk insurance facility for the Philippines which will institutionalize this innovative approach to financing disaster risk. The program provides proof of concept for a joint approach towards parametric catastrophe risk insurance.

Will this parametric catastrophe insurance be enough to make the Philippines resilient against natural disasters?

Disaster risk finance is only one component of managing disaster risk. Parametric catastrophe insurance (as well as other risk financing mechanisms) provides financing to recover from disasters after they occur and to build financial resilience.

This needs to be complemented with work to manage and reduce the risk of disasters.

The parametric insurance complements other financial protection instruments in the Philippines, , including a contingent line of credit with the World Bank Group, which provides US$500 million of standby financing to help manage the financial impacts from more frequent, moderate-impact disasters, and the national and local DRRM Funds for very frequent, relatively low-impact disasters.

Besides this program, what else can the Philippines do to make the country resilient against disasters?

The Philippine DRRM Act, the National DRRM Framework, and the National DRRM Plan bring together necessary actions for building resilience, including

- Risk identification (such as hazard mapping, risk assessments, and infrastructure vulnerability assessment)
- Risk reduction (such as strengthening and retrofitting of vulnerable infrastructure, and better integration of disaster risk reduction measures in the National Building Code of the Philippines)
- Preparedness (through forecasting, early warning systems, and community-based disaster risk management)
- Effective planning for disaster recovery (including developing social protection systems specifically for disaster-affected people)
- Financial protection mechanisms, such as this program

Financial protection complements disaster risk reduction by helping a government address the risk that (despite interventions) remains—and that may not be feasible or cost-effective to mitigate.

What conditions contributed to implementation of this program and serve as a lesson for future programs around the globe?

- Strong leadership by Department of Finance and long term policy dialogue on disaster risk finance and disaster risk management in the Philippines
- An integrated disaster risk finance, with this program compliment-ing other risk financing instruments
- Access to neutral, independent technical advisory services
- Strong political support for a program and an enabling policy environment
- Existence of international market standard catastrophe risk model at the national and subnational level
- Strong market appetite for emerging market catastrophe risk
- Strong relationship of the World Bank with international insurance and reinsurance companies
- Close collaboration across technical stakeholders

What is the role of the World Bank in this program?

The World Bank helped the government achieve the best terms and conditions for this program by issuing a reinsurance contract to GSIS and in turn passing the risk to international reinsurance markets. This allowed the government to benefit from the World Bank's AAA credit rating and its long experience in bringing together a panel of international market players to achieve the best pricing possible. Since 2009, the World Bank has issued, hedged, or facilitated over US$2.5 billion in transactions designed to transfer earthquake, wind, pandemic, and drought-related risks for client countries around the world.

The World Bank mobilized grant resources from the UK Department for International Development to cover the preparation costs and service fees for this program on an exceptional basis.

Disaster Risk Financing & Insurance Program

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