CASE STUDY

Insuring the Philippines against Natural Disasters

OVERVIEW

The Philippines, as one of the most disaster-prone countries in the world, requires considerable fiscal resources to support rapid response and recovery after severe typhoon and earthquake events. To alleviate fiscal pressures and meet these needs, the World Bank partnered with the Philippines to design and implement a parametric catastrophe risk insurance product that provides immediate financial liquidity required by the national government agencies and 25 individual provinces after a disaster.

Residents affected by typhoon Haiyan (Yolanda) carry on with their daily activities
Photo: Dominic Chavez/World Bank

Background

The Philippines is among the world's most disaster-prone countries, with high exposure to tropical cyclones, earthquakes, and other natural hazards.[1] In recent years, the government of the Philippines has improved its capacity to finance disaster response by establishing national and local level funds as well as contingent credit lines. However, the financing needs of severe disasters continued to exceed these resources and left the country vulnerable during the critical emergency response phase.

Catastrophe risk insurance can be used to provide financial protection against natural disasters. As an emerging economy, the Philippines faced challenges accessing such insurance and decided to partner with the World Bank to design a customized approach.

Financing Objectives

The Philippines government worked with the World Bank to meet several aims:

- Gain access to international reinsurance markets
- Create a mechanism allowing national government agencies and local government units to obtain more cost-effective insurance coverage
- Design a customized policy for quick disbursement of post-disaster payouts
- Combine currency hedging with insurance to provide payouts in Philippine pesos

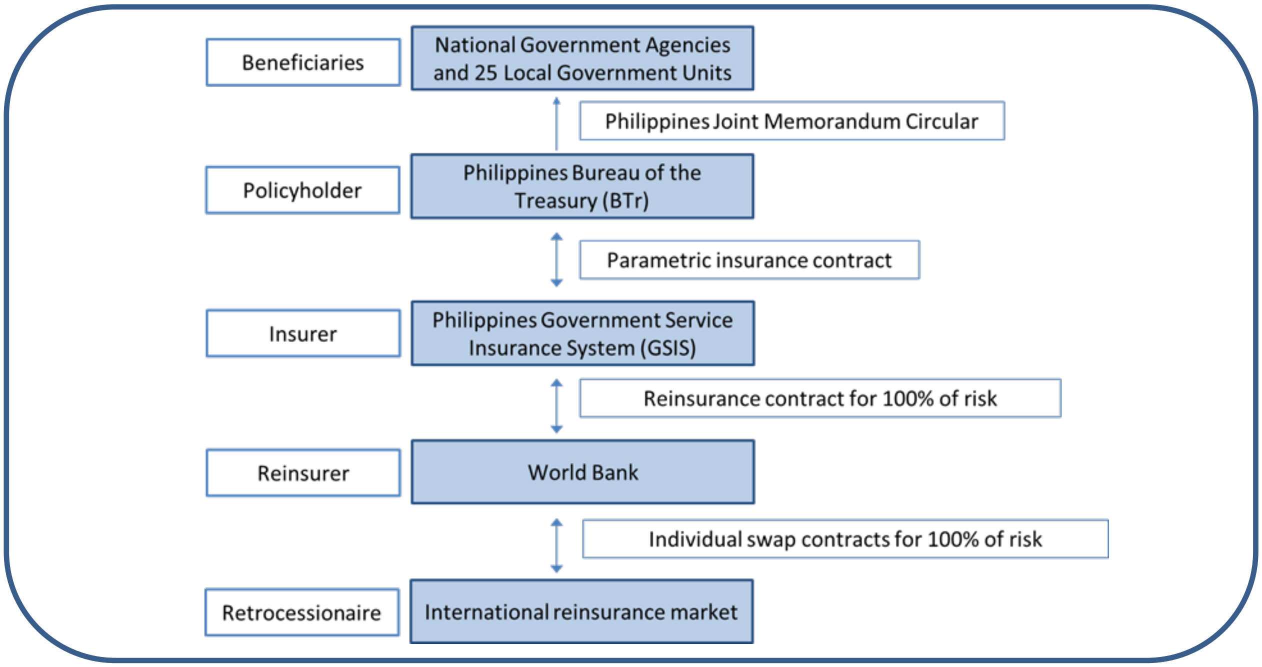
[1]The UN Office for Disaster Risk Reduction reports that between 1995 and 2015, the Philippines endured a total of 274 natural disasters, including earthquakes, volcanic eruptions, tropical cyclones, and floods, making it the fourth most disaster-prone country in the world. The events affected a total of 130 million people.

Financial Solution

The Philippines obtained a parametric catastrophe risk insurance policy[2] offering earthquake and typhoon coverage to national government agencies and typhoon coverage to 25 individual provinces. Total annual coverage in the first year of the program (2017/2018) was US$206 million; coverage nearly doubled to $389 million in the program's second year (2018/2019).

The World Bank acted as an intermediary to transfer the risk out of the country by reinsuring the risk and simultaneously executing catastrophe swap transactions with the international market.

Structure of the Transaction



Outcome

This transaction was the first of its kind in the Philippines and also marks the first time that the World Bank entered into a reinsurance agreement with government agencies. In addition, it was the first time a catastrophe risk transaction was executed in local currency. The transaction was designed to provide the government with rapid post-disaster liquidity—to support emergency response and maintain essential services until additional resources become available—from a AAA-rated counterparty. In the first year of the program, the policy paid out approximately US$1.6 million following Typhoon Vinta in December 2017.

Several conditions made the transaction possible:

- Existence of catastrophe risk models at the national and subnational levels that met international market standards

[2] Parametric insurance is a type of insurance that makes a specified payment upon the occurrence of a triggering event that meets pre-agreed criteria, such as a specific earthquake magnitude or typhoon intensity. Since the payment of claims depends on parametric triggers, and not on actual losses that would take time to assess in the field, claims can be paid quickly—usually within weeks, compared to several months for traditional insurance. The Philippines' policy pays outs to the government within 24 days after notification of a covered event.

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- Strong appetite for emerging market risk in the international markets
- Strong relationship between the World Bank and international insurance and reinsurance companies
- Strong political leadership and long-term policy dialogue on disaster risk finance and disaster risk management in the Philippines
- Close internal and external collaboration among various stakeholders in the transaction
- Leveraging of donor funds to support program preparation and development

World Bank's Role

The World Bank offers client countries comprehensive insurance and other financing solutions to address the potentially high cost of disasters and climate shocks. In the Philippines, the World Bank focused on knowledge transfer and technical capacity building while working in close partnership with the government to develop, design, and execute this catastrophe risk insurance transaction. The country achieved the favorable terms and conditions for the transaction by leveraging the World Bank's position in the international markets and its placement capacity.

The World Bank's multilateral legal status allows it to act as an intermediary to simplify catastrophe risk transactions. In addition, the World Bank can perform the following roles:

- Accommodate different legal and regulatory environments
- Standardize documentation to reduce intermediation, legal, and modeling costs as well as placement fees
- Guide the outreach and investor discussions to promote more competitive pricing
- Build the capacity of clients to undertake future transactions on their own

Expanding access to parametric catastrophe risk insurance is one of the many ways the World Bank Group helps member countries build resilience against economic and natural disaster risks. IBRD's AAA credit rating, market presence, and convening power allow the World Bank Treasury Banking Products team to develop innovative products that help clients maximize financing and mitigate risk.

Examples of Catastrophe Risk Coverage around the World

Mexico issued a multi-peril catastrophe bond using the World Bank's MultiCat Program, which helps sovereign and subsovereign entities pool multiple perils in multiple regions and reduce insurance costs. In 2015, when Mexico was hit by Hurricane Patricia, the second-most intense tropical cyclone on record worldwide, it received a US$50 million payout. Mexico has additional protection against earthquakes and named storms in the form of a World Bank–issued $360 million catastrophe bond; following an 8.2 magnitude earthquake in southern Mexico in September 2017, the country received a US$150 million payout.

In Uruguay, the World Bank executed a US$450 million weather and oil price insurance transaction for Uruguay's state-owned electricity company UTE. The transaction insured the energy company for 18 months against drought and high oil prices.

The World Bank helped Pacific Island countries develop their disaster risk insurance policies, not only providing technical assistance but also acting as an intermediary to place the country-specific catastrophe risk policies on the international reinsurance market as a single, well-diversified portfolio. Cyclone Ian (2014) in Tonga resulted in a payout of US$1.27 million, and Cyclone Pam (2015) in Vanuatu led to a payout of US$1.9 million.

In the Caribbean, the World Bank provided cat swap coverage from 2007 to 2014; in 2014, it issued a three-year catastrophe bond linked to hurricane and earthquake risk in the Caribbean Catastrophe Risk Insurance Facility (CCRIF) member countries. Throughout the life of the coverage, 10 member governments received 21 payouts totaling approximately US$68 million.

The World Bank issued a US$1.4 billion catastrophe bond to provide earthquake cover to Chile, Colombia, Mexico, and Peru on February 7, 2018.

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