THE NEW IDB INSURANCE FACILITY

Natural Disasters Insurance Facility for Central America and the Caribbean
High Exposure in the Region

Natural disasters have had significant impact on the economic and social development of Latin America and the Caribbean. Since 1975, disasters in the Region have on average affected 4.7 million people annually, causing some 5,300 deaths and US$3.3 billion in physical losses per year 1.

INTEGRATED DISASTER RISK MANAGEMENT APPROACH

Confronted with the high exposure to adverse natural events in the region, the Inter-American Development Bank (IDB) has developed an integrated disaster risk management approach to support the countries. It comprises the following four components:

1. National Risk Evaluation
2. Prevention and mitigation measures
3. National and local institutional strengthening
4. Risk retention and risk transfer financing mechanisms

IDB’s Financial Approach to Natural Disasters

To have a complete vision in its approach to deal with natural disasters, the IDB has included the development of country financial strategies to improve the financial planning and management of natural disasters.

The IDB is making available new financial instruments to countries that commit to advance the development of all the four components of “the Approach,” therefore creating a powerful incentive to reduce the natural disaster risks in the prevention phase.

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In addition, the financial strategy itself provides a range of financial options to cover the initial phase after natural disasters. These options include the following instruments:

- Investment loans
- Contingent credit lines
- Risk transfer financing

The IDB Regional Insurance Facility

The IDB, in cooperation with Swiss Re, an internationally recognized leader in disaster risk financing, has developed an innovative insurance facility to mitigate the economic impacts of catastrophes for the countries of Central America and the Caribbean, a regional facility that could eventually be extended to additional countries.

The RIFCA (Regional Insurance Facility for Central America), is a standardized decentralized institutional structure that provides a revolutionary solution for the most efficient transfer of insurable risks from the governments to the international financial markets. Through it, each participant country will be able to:

- Mitigate the financial impact of natural disaster events.
- Strengthen growth stability in their economies by transferring the risk to the international insurance and capital markets.
- Obtain efficient financial coverage of extraordinary public expenditures during emergencies immediately after a catastrophic disaster.
Innovative Parametric Insurance Mechanism

The RIFCA innovative model, which measures risk for different types of perils, will allow the development of cost-effective parametric natural disaster risk coverage for Central America.

The RIFCA introduces a new coverage modality based on parametric modeling of exposed population, as opposed to classical indemnity-based solutions. The use of physical events intensity parameters enhances precise calculation of the effectively exposed population and payouts to the countries.

These innovative parametric coverage triggers will considerably reduce the basis risk through better correlation between effective payouts and the actual level of extraordinary expenditures that governments will have to face during the emergency, in the aftermath of a catastrophic event.

The comprehensive hurricane model in this mechanism is the only one in the world that uses accumulated runoff, flood basins, and soil conditions resulting from wind, rainfall floods and landslides to calculate the compounded total exposure and the consequent coverage payout.

Some Facility Features

- The IDB is the main RIFCA promoter. It will provide technical advice to the participating countries and grant financing for the design and structuring of the individual country facilities.
- Each individual country facility will be solely and fully owned by the country and will allow governments to acquire pluriannual (5 years) reinstatable natural disaster coverage for one or more perils (typically earthquake and/or hurricane).
- The facility design allows the countries to set up collective arrangements that would enable them to benefit from a joint reinsurance placement (lower premium and administrative costs).
- The RIFCA long term growth and financial sustainability will be ensured by a strong capitalization of the individual countries facilities, allowing early year’s partial capital base shielding, while still providing significant risk retention capabilities.
Financing the Initiative

The IDB has committed itself with its IDRM Approach offering new financial instruments like the Contingent Credit facility for US$600 million (loans up to US$100 million per country) but also grant financing, US$2.5 million in non reimbursable technical assistance, for providing the technical expertise to develop the IDRM and mainly to establish RIFCA as a financial instrument catering to the needs of Central America and the Caribbean. As we move forward we seek new donors to provide the financial support needed to achieve the necessary strong initial capitalization at an affordable cost for the beneficiary countries.

In addition, the new scenario for Central American countries occasioned by the recent financial crisis is producing additional stress in their fiscal situation and increasing pressure on their public debt profiles.

It is crucial to reduce the catastrophic natural disasters impact on the public finances by relieving the costs of structuring an adequately capitalized insurance facility that could provide much needed long term disaster emergencies cost coverage at a reasonable price, to countries with demonstrated commitment to effective natural disaster risk management.

The RIFCA will direct the donors’ contributions to capitalize the countries’ individual insurance facilities or partial premiums financing during an initial take-off period.

Our Final Goal - Empowering Countries

• Establishing a market based reinsurance mechanism that provides catastrophic disaster emergency insurance directly to governments
• Enabling the countries to move away from foreign-aid and debt dependency towards ex-ante disaster risk financing, and an active contingent liabilities management approach
Frequently Asked Questions

What are the benefits of the Facility?
The Facility offers tremendous benefits to all stakeholders on financial natural disaster management.

- It will enhance the efficient use of the IDB’s and Donor’s Financial Resources. Enabling the transfer of substantial parts of the region’s catastrophic disaster risk to the private sector, the Facility will free more resources from both the IDB’s, traditional donor’s capital, and disaster funds for other priorities or more dire catastrophes.
- The facility will enhance the participant countries’ long term growth stability by smoothing out the economic impact of catastrophic emergencies through the provision of cash resources immediately after a disaster, allowing a faster and less costly economic and social recovery.
- It will be instrumental in promoting the development of broader and deeper domestic insurance markets; creating new opportunities for effective risks management for the local private sector and introducing new international institutional investors to the region.
- The Facility can be broadened beyond natural catastrophes by developing new products and insuring other insurable risks. Foremost among them: climate and weather related risks that impact the agricultural sector and food production.
- This Facility will provide an additional instrument for the countries to tackle economic and financial volatility.

What is the main difference between the Caribbean Catastrophe Risk Insurance Facility (CCrif) and this Facility?
The central difference is that the CCRIF operates as a mutual insurance company, with the countries collectively controlling one captive and one reinsurance policy, while the RIFCA will operate with individual captives and risk transfer programs for each sponsor.

An analogy from the technology sector could be that the CCRIF is like a single super computer shared by a department, while the RIFCA is like a network with
common applications but with each desktop built for an individual user’s needs. The advantages of this approach are:

- **Customization:** The RIFCA builds on the IDRM Approach by customizing the insurance facility, including the insurance policy, perils covered and retention capabilities, to the specific needs of each country. At the same time, through the common captive setup and risk transfer structure, the RIFCA will gain many of the benefits of risk diversification and economies of scale.

- **Correlation:** Given the diversity of exposure among the countries, the RIFCA will use an innovative parametric hurricane and earthquake coverage that pays based on the percentage of the population affected by the disaster. This measurement better correlates to the true expenses a government may face after a disaster and creates an easy to understand and common framework for all governments.

- **Replication:** Given the common architecture, individual sponsors can join the RIFCA by establishing their own captives, just as a new desktop would be added to a network. Countries can consequently enter the RIFCA at their own pace and transfer the level of risk suited to their fiscal needs without compromising risk management. This will greatly expand the suitability of the RIFCA to countries large and small.

**Why did the IDB opt to work with Swiss Re instead of other industry players?**
The IDB approached several companies seeking a comprehensive proposal that would include design and implementation of captive insurance vehicle structures, hurricane models and a risk transfer structure using reinsurance and capital markets products. Swiss Re was the sole proactive respondent to this multi-stage request and the company with a unique ability and regional experience to model parametric hurricane, floods and landslides coverage, and to meet the structuring requirements pursued by the IDB.

**How much will it cost?**
Each country will have its own individual insurance facility and will be able to select the type of events to be covered, the amount of coverage for each type of event, and even the level of reinsurance to be bought from the international markets. Therefore, the price of the annual premiums may vary among countries. Preliminary estimates, under current market conditions, are that the average annual cost per country, for the countries being initially considered in the region, would be about US$2.5 million per peril, for US$50 million coverage to be triggered by events affecting more than 5% of the country’s population.
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