



PCRAFI PROGRAM - PHASE II

Enhancing the financial resilience of Pacific Island Countries against natural disaster and climate risk

BACKGROUND

At the 2015 Forum Economic Ministers Meeting (FEMM) in Cook Islands, the Finance Ministers of the Pacific Island Countries (PICs) agreed to establish the PCRAFI Facility to provide disaster and climate risk insurance. In addition, it was agreed to domicile the Facility as an independent legal entity in the Cook Islands and for the Facility to be effective by August 2016. This is a major achievement in the development of the PCRAFI insurance program that demonstrates the willingness and commitment of the PICs to establish their own management entity to ensure the sustainability and further development of the PCRAFI insurance program.

The PCRAFI Facility will provide the PICs with climate and disaster related insurance with the aim to increase the financial resilience of PICs against natural disasters. By providing parametric insurance solutions to the PICs the PCRAFI Facility will help build their financial response capacity to meet post-disaster funding needs without compromising their fiscal balances and development. It will also provide the PICs with greater ownership of disaster and climate risk financing at the regional level, giving them control and influence over the design of future disaster and climatic risk solutions. The Facility will also be able build reserves, which will allow it to retain some of the risk and transfer the remainder to the reinsurance market when it is the most cost-effective, leading to further insurance premium reduction.

PCRAFI PROGRAM

The PCRAFI Program has two core components:

- **PCRAFI Facility:** established as an insurance captive, designed to provide the PICs with catastrophe risk insurance coverage on competitive terms; and
- **PCRAFI Technical Assistance (TA) program:** which aims to provide the PICs, regional organizations and the PCRAFI Facility, with technical assistance and capacity building on disaster risk financing and insurance and on public financial management of natural disasters.

Donor partners have expressed strong support to the PCRAFI Program during COP 21. During COP21 in December 2015 in Paris, as part of the InsuResilience initiative championed by the G7, several donor partners including Germany, UK, USA and Japan have pledged to support the development of the PCRAFI Program, both for the capitalization of the PCRAFI Facility and the provision of technical assistance.

The PCRAFI Program will be supported by the PCRAFI Multi-Donor Trust Fund (MDTF) with the World Bank as Trustee. The PICs called upon the World Bank and donor partners to support the PCRAFI Program during 2015 FEMM. In direct response to this request, the World Bank is currently working with donor partners to secure funds and to establish the PCRAFI MDTF. See Figure 1.

The PCRAFI Program is designed and operated according to the following six key principles:

- (1) **Country ownership.** The PCRAFI Facility provides the PICs with a regional body accountable to them, giving them control and influence over the design of future disaster and climate risk tools. PICs recognize that for the long-term sustainability of the program they must take regional ownership.
- (2) **Financial Sustainability.** The Program, and especially the PCRAFI Facility, is designed to be financially sustainable in the long run based on sound actuarial principles that adequately account for the underlying risks and operating expenses. This will ensure that the initial capital injection is not depleted and can even grow over time.
- (3) **Contingency Planning.** Contingency planning can ensure timely and effective use of funds (including insurance proceeds) post disaster. Such plans should be agreed ex ante to avoid any delays to financing response in the aftermath of a disaster. Such plans should also give the PICs flexibility over the use of the insurance proceeds according to their own priority (as per the principle of country ownership). The PICs have already developed post disaster budget execution manuals to reinforce the key principles of sound public financial management by ensuring rapid budget mobilization and execution following the declaration of emergency.



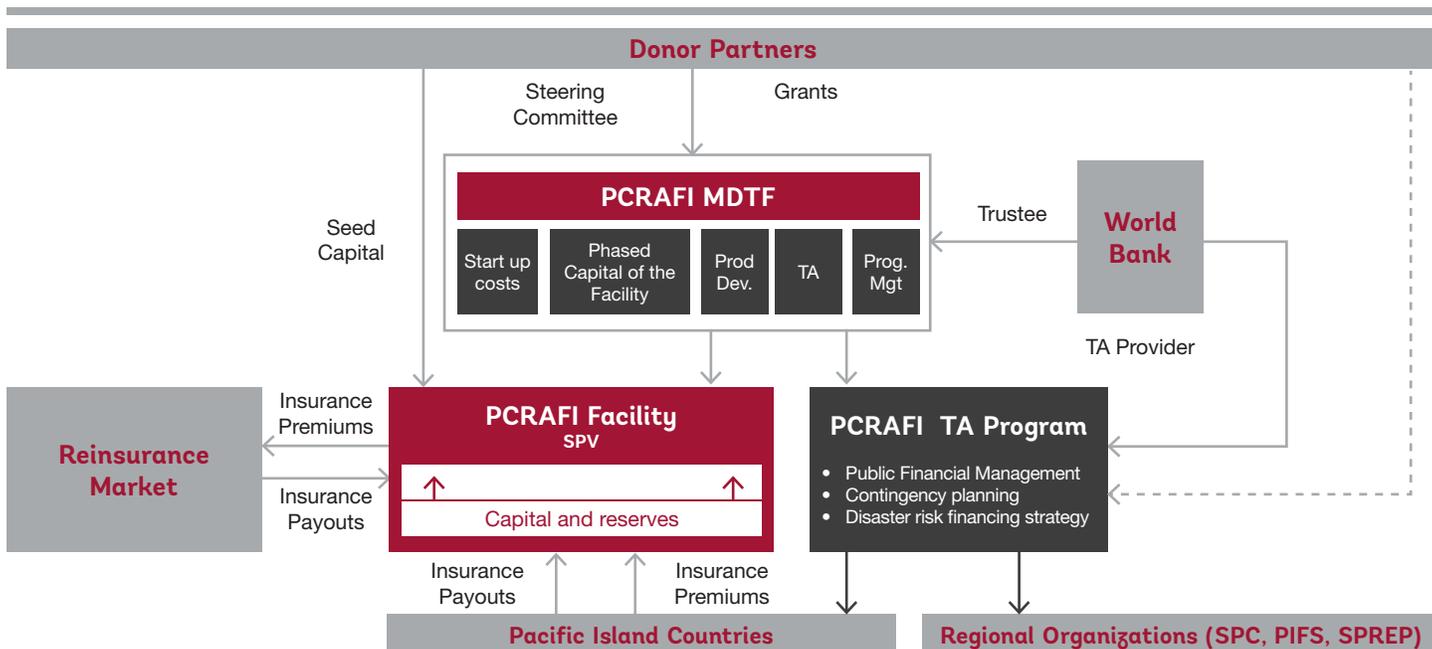
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GFDRR



FIGURE 1. PCRAFI PROGRAM



(4) Accountability and transparency. While this has not been a requirement of the PCRAFI program to date both Vanuatu and Tonga, who received an insurance payout, have been transparent on their expenditures providing detailed information on how the payouts were used.

(5) Comprehensive disaster risk financing strategy. While catastrophe risk insurance contributes to the increased financial resilience of the PICs against natural disasters, it is only one component of a comprehensive disaster risk financing strategy. Institutional capacity building on public financial management of natural disasters, including post disaster budget execution, will complement catastrophe risk insurance.

(6) Link with disaster risk management agenda. Disaster risk financing is part of the broader disaster risk management agenda, which aims to mitigate/reduce the disaster risks faced by the PICs. The PCRAFI Program is executed in partnership with the Secretariat of the Pacific Community (SPC) who holds the regional mandate for disaster risk management. Disaster risk management plans have been developed by each PIC under the Hyogo framework and now the Sendai framework.

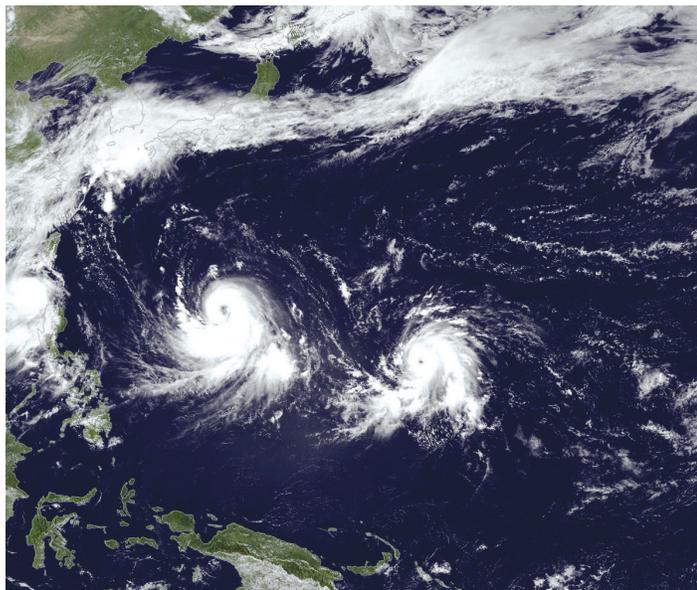
The PCRAFI Program is aligned with other regional initiatives such as the Pacific Resilience Program (PREP), an IDA-funded regional program that is designed to strengthen early warning, resilient investments, and financial protection in the Pacific region. The PCRAFI Program also builds on similar initiatives in the Caribbean (CCRIF) and in Africa (Africa Risk Capacity) and as such creates the opportunity for knowledge exchange across the three institutions.

PCRAFI FACILITY

The PCRAFI Facility is to be established by August 2016.

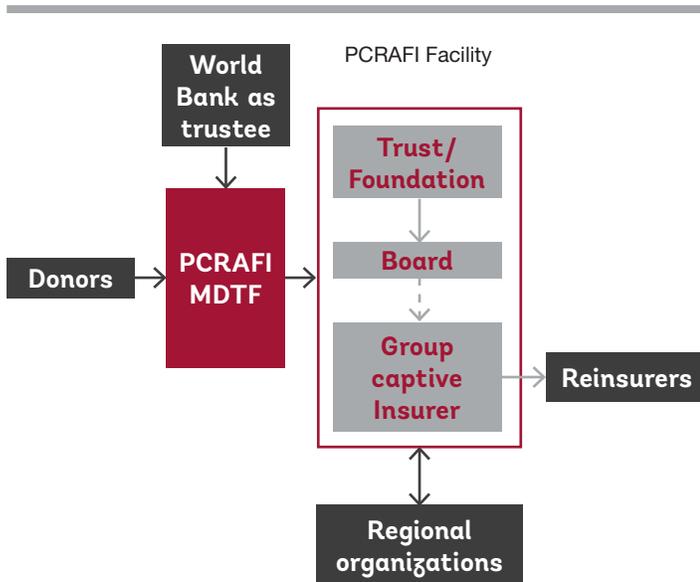
This will enable the Facility to manage the renewal of the PCRAFI insurance policies for the fifth season running from November 1, 2016 to October 31, 2017.

The PCRAFI Facility will be established in Cook Islands as a Trust or Foundation with a Board of Directors that holds a special purpose vehicle (SPV) in the form of a group captive insurer. This structure, established in the Pacific region and owned by the beneficiary countries, would ensure high ownership by the PICs. The Cook Islands have been identified as host jurisdiction for the PCRAFI Facility following the completion of legal due diligence. The Cook Islands have insurance legislation and supervision that recognize the particular needs of oversight required to host a captive insurer. See Figure 2.



Two typhoons and one tropical storm in the northern Pacific Ocean on July 6 and 7, 2015. From left to right: Tropical Storm Linfa is in the South China Sea. Typhoon Chan-Hom is heading west-northwest toward the East China Sea. Typhoon Nangka is making its way east of Guam. Photo credit: NOAA

FIGURE 2. STRUCTURE OF PCRAFI FACILITY



A technical working group comprised of the Secretaries of Finance of the participating PICs has been established to prepare the operations manual of the PCRAFI Facility. The mandate of the Facility are twofold; (i) to increase the number of participating PICs; (ii) to develop new disaster risk insurance products to address the needs of the PICs.

The Facility will be structured to keep the operating costs at a minimum. Establishing a dedicated PCRAFI Facility for the management of the PCRAFI insurance program will keep the operating costs to a minimum while offering greater control over the future development of disaster- and climate-related insurance tailored to the PICs. As the portfolio grows, operating costs (which will be relatively high in the initial years) will form a smaller proportion of total cost creating economies of scale as the Facility spreads these costs over more business.

The Facility will require initial capital. Initial capital will be required in order to allow the Facility to retain some risk and purchase reinsurance when it is the most cost-effective. It will also help generate additional income to cover the day-to-day operations of the Facility. This will therefore allow the Facility to further reduce the insurance premium paid by the participating PICs while ensuring its long term financial sustainability.

PCRAFI TECHNICAL ASSISTANCE PROGRAM

Technical assistance and institutional capacity building on disaster risk financing and insurance will be provided through a program of activities designed to strengthen the institutional capacity of the PCRAFI Facility, national and regional level organizations as well as the Ministries of Finance of beneficiary PICs.

- **Technical assistance to the PCRAFI Facility** will support the establishment of the Facility and the project management and operational support to the PCRAFI insurance program's linked activities. It will also facilitate technical collaboration with similar

regional facilities, in particular, the Caribbean Catastrophe Risk Insurance Facility (CCRIF) and Africa Risk Capacity (ARC).

- **Regional level technical assistance** will be provided to the regional agencies of the Council of Regional Organizations of the Pacific (e.g. Secretariat of the Pacific Community [SPC], Pacific Islands Forum Secretariat [PIFS]) while leveraging their expertise such as risk assessment for SPC and political dialogue for the PIFS.
- **National level technical assistance** for the Ministries of Finance of the beneficiary countries in coordination with those ministries responsible for disaster risk management will support; (i) capacity building in post disaster public financial management including post disaster budget execution, mobilization and reporting the development of disaster risk financing tools; (ii) the development of ex ante contingency plans; (iii) the development of financial models to help assess the fiscal exposure to natural disasters; and (iv) the development of disaster risk financing strategies.

ROLE OF DONOR PARTNERS

Donor partners will continue to play a critical role in the development of the PCRAFI insurance program and the establishment and capitalization of the PCRAFI Facility. Donor partners have supported the development of the PCRAFI insurance program during the three seasons (Jan 2013-Oct 2015) through the Pacific Disaster Risk Financing and Insurance Multi-Donor Trust Fund (MDTF) and the Japan Disaster Risk Management single donor trust fund held at GFDRR. Donors will continue to play a critical role through providing capital to the PCRAFI Facility and help the Facility build up its reserves over its first years of operation and through providing financial support to the PCRAFI TA Program.

The PCRAFI MDTF will have a steering committee, comprised of representatives of partner donors and the World Bank. The steering committee will (i) provide strategic direction and oversight of activities supported under the MDTF and (ii) review and monitor the establishment and operationalization of the Facility and the use of technical assistance.

NEXT STEPS

The Technical Working Group (TWG) comprised of the Secretaries of Finance from the PCRAFI member countries will meet on April 11-12, 2016 to finalize the draft operations manual for the Facility. The TWG are currently working on a preliminary operations manual, governance structure and work plan for the PCRAFI Facility. During this meeting the TWG will agree on the draft manual and pursue Cabinet approval of the operations manual by May 2016.

Establishment of the PCRAFI MDTF by end of April 2016. The World Bank will continue to liaise with donors to ensure that the PCRAFI MDTF become operational by the end of April in order to provide support to the PICs as needed. It is tantamount that the MDTF is operational by the end of April in order to commence the program of work. However, the World Bank will continue to seek additional support from donor partners.

Establishment of the PCRAFI Facility by August 2016. This will enable the phased handover of work for the PCRAFI insurance program from the World Bank to the Facility by ensuring that the Facility is operational for the implementation of the fifth season of insurance coverage to start on November 1, 2016.

Increase the number of participating PICs within the Pacific catastrophe risk insurance program. Expansion of the insurance pool is expected to continue in the medium term with countries like Fiji and FSM expressing their interest to join.

Develop additional disaster risk insurance products to cover losses “below the insurance deductible”. Hybrid disaster risk insurance (products based on parametric trigger and soft trigger such as declaration of emergency to cover medium size disasters) will be designed to finance disaster events that result in mid-level damage, that is, those that are not covered by the PCRAFI insurance because they are “below the insurance deductible”, but yet are too large to be financed solely by domestic reserves. This product is being developed at the request of PICs during 2015 FEMM. It will require additional seed capital and close collaboration with the private sector.

HISTORY OF THE PCRAFI PROGRAM

Launched in 2007, PCRAFI aims to provide the PICs with disaster risk assessment and financing tools for enhanced disaster risk management and climate change adaptation. One of the key outputs of the PCRAFI program was the development of the Pacific Risk Information System (PacRIS) which contains

information on the hazard, exposure and vulnerability of fifteen PICs. This includes a database of over 5 million buildings and their attributes, the largest of its kind in the Pacific. PacRIS has been used to inform urban planning as well as to support the development of the PCRAFI insurance. The PCRAFI Insurance program was launched on January 17, 2013 and designed to provide the PICs with parametric insurance as a mechanism for rapid response financing through immediate injection of cash following a major tropical cyclone and/or earthquake/tsunami.

PCRAFI insurance is a successful example of public-private partnership. Launched in January 2013, the insurance program has been piloted with five Pacific island countries (PICs): Vanuatu, Tonga, Marshall Islands, Samoa, and Cook Islands. Working together, PICs have been able to secure aggregate insurance coverage in excess US\$43 million against tropical cyclones and earthquakes/tsunamis. The World Bank has acted as an intermediary between PICs and a group of international reinsurance companies — *Sompo Japan Insurance, Mitsui Sumitomo Insurance, Tokio Marine & Nichido Fire Insurance Swiss Re and Munich Re. AIR Worldwide* provides the underlying risk modeling for the transaction. Japan generously provided co-financing of the insurance premiums during the first three years of operations. Since 2016, the PICs are paying their premium in full.

Since its inception the PCRAFI insurance portfolio has made two payouts for an aggregate amount of US\$3.2 million within 10 days of the disasters. Tonga received a payout of US\$1.3 million within 10 days of being affected by Tropical Cyclone Ian in January 2014. Vanuatu received a payout of US\$1.9 million within 7 days of being affected by Tropical Cyclone Pam in March 2015.

About PCRAFI

The current PCRAFI program, phase II builds on the initial phase of the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI), a joint initiative of the World Bank, SPC, and the Asian Development Bank with financial support from the Government of Japan, the Global Facility for Disaster Reduction and Recovery (GFDRR) and the European Union. PCRAFI, launched in 2007, aimed to provide the PICs with disaster risk assessment and financing tools for enhanced disaster risk management and climate change adaptation.

The PCRAFI Program (phase II) launched in April 2016 is comprised of two key pillars; (i) the PCRAFI Facility and (ii) the PCRAFI Technical Assistance Program.

About the Pacific Resilience Plan (PREP)

The PREP is designed to address the challenges posed by disaster and climatic hazards consolidating the national and regional programs such as PCRAFI that have been undertaken by the World Bank to date. The PREP designed to (i) strengthen early warning and preparedness; (ii) create a framework for stronger and prioritized investments in resilience and retrofitting of key-public assets to meet international standards; and (iii) improve the post-disaster response capacity of the countries through strengthened financial resilience to disaster events. Under the PREP premium financing for the PICs has been secured until October 2018.

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