Understanding the Relevance of PCRIC's Parametric Insurance After a Disaster

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PACIFIC CATASTROPHE RISK INSURANCE COMPANY

There is growing concerns that the Pacific disaster risk finance (DRF) space has become crowded. Whilst this may be to some, it isn't for PCRIC who views the region's DRF landscape as still adequate to accommodate other instruments, including PCRIC's parametric insurance.

At the outset, it is important to understand that the DRF instruments that are accessible globally were uniquely designed to mitigate risks at different levels of disaster frequencies and severity. PCRIC's parametric insurance products are not an exception as they are designed to provide immediate liquidity to PICs to assist with their relief efforts.

What Type of Insurance Does PCRIC Offer?

PCRIC was established as a captive insurer[1] that would offer sovereign parametric insurance to PICs and its current policies cover (i) Tropical Cyclones (TC); and (ii) Earthquakes, which include tsunamis induced by earthquakes. These policies are targeted at Governments and member countries may choose one or both policies, with payouts being made within 10 days of an eligible disaster event occurring. Three PICs currently hold PCRIC insurance cover and these include Cook Islands, Tonga and Samoa. Since 2016, PCRIC has executed a total payout of approximately US$8m to Tonga, which comprises of US$3.5m and US$4.5m for Tropical Cyclone (TC) Gita (2008) and TC Harold (2020) respectively. This is against a total premium of USD$2.90m, which the government has paid to date. Using the above as a case study, Tonga has realized a net benefit of US$5.09m.

Image Supplied by the Tonga National Emergency Management Office

[1] In December 2021, the PCRIC Act was amended to convert PCRIC into a Segregated Cell entity which would allow the entity to also offer non-sovereign products.

Policies issued by PCRIC disburse payouts based on the modelled losses associated with the above perils as calculated by a catastrophe model. As there is no loss-adjustment process, parametric insurance allows payouts to be made very quickly after a disaster event.

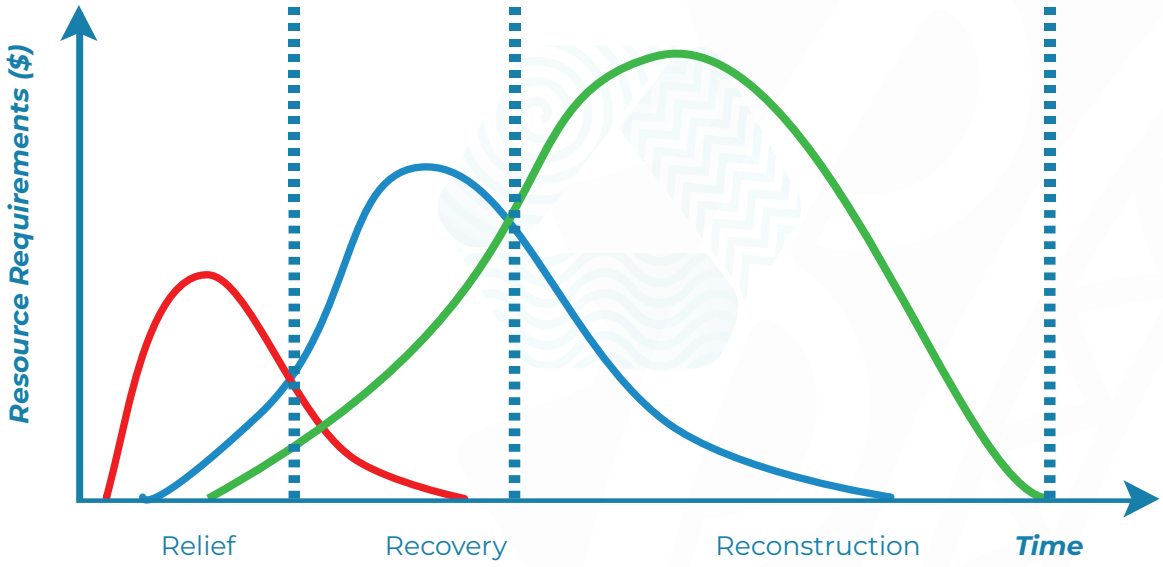
Image Supplied by the Government of Samoa-DMO / NEOC

What Disaster Phase is PCRIC Instruments Relevant?

World Bank (2017)[2] states that understanding the timing of needs is essential. Therefore, in the aftermath of a major disaster, governments will not require the money needed for the entire reconstruction program all at once. While immediate liquidity is crucial to support **relief** and early **recovery** operations, the government has more time to mobilize the larger resources for the **reconstruction** program as shown in Figure 1 below.

[2] World Bank. 2017. Disaster Risk Finance: A Primer.

Figure 1: Liquidity Needs Over Time Post Disasters



Source: World Bank, 2010[3]

DRF is guided by four core principles, which include (i) timeliness of funding: (ii) disbursement of funds; (iii) disaster risk layering; and (iv) data and analytics. In accordance with timeliness of funding, the liquidity from **PCRIC's insurance payout is more relevant to the relief phase**, given that a maximum of 10 days is allocated to complete the processing of the cash payout to its client countries. However, it is at the discretion of governments to spend the insurance proceeds towards speeding up recovery and reconstruction.

Apart from parametric insurance, there are a number of DRF instruments or sources of finance that are accessible in the region and these include and are not limited to national contingency funds, national emergency budgetary allocations, budget reallocations, ex-ante[4] and ex-post[5] contingent credits / financing, and international assistance.

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[3] World Bank, 2010. Financial Protection against the State against Natural Disasters – A Primer.

[4] Ex-ante instruments refer to instruments that are pre-arranged before a disaster.

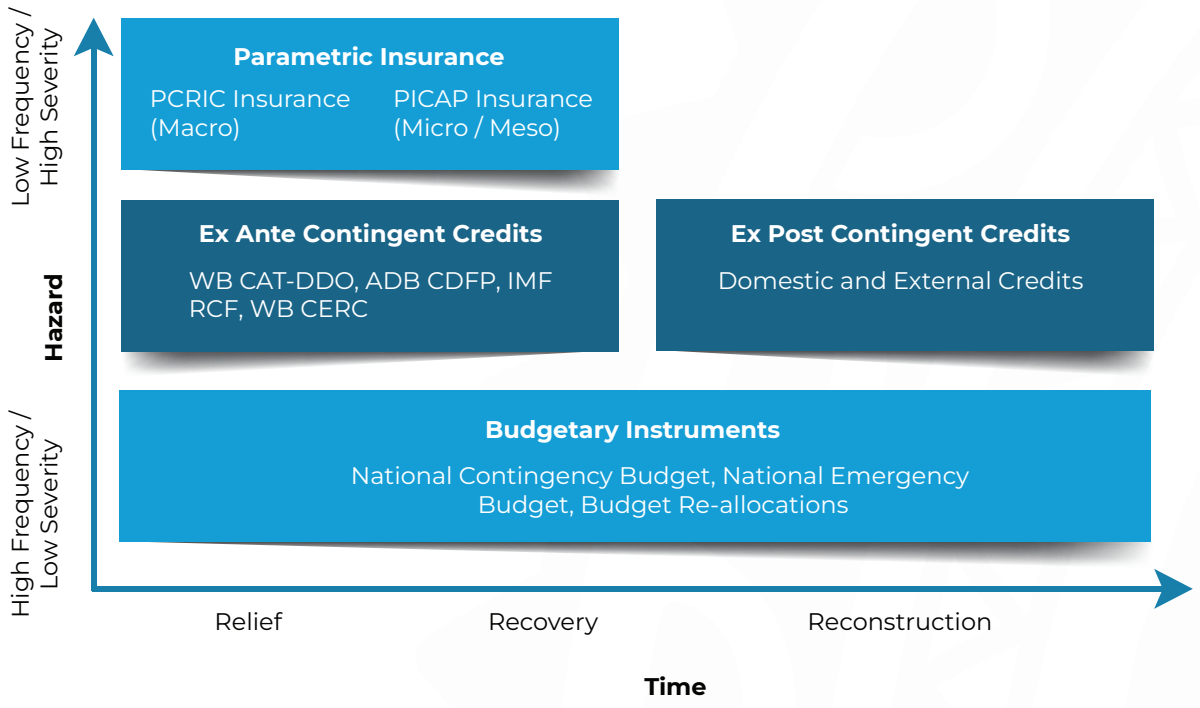
[5] Ex-post instruments refer to those that are arranged after a disaster.

With regards to the core principle on disaster risk layering, PCRIC's current sovereign insurance alone, or any of the other DRF instrument accessible in the region, cannot address all the risks on their own, hence PICs need to have some fair understanding of what instruments to apply against each disaster type, depending on its frequency and severity. PCRIC's current sovereign parametric insurance products were designed for governments i.e., at the macro level and is targeted at disasters with low frequency but high severity. These would include TCs at categories three (3) and above, or earthquakes with a magnitude of six (6) and above on the Richter scale, inclusive of a resulting tsunami if applicable. Figure 2 below illustrates the risk layering for accessible instruments in the region based on disaster frequency and severity and their relevance in terms of the three phases of disasters.

It is important to note that the various sources of finance should not be seen as alternatives to each other, but complement each other as part of a comprehensive and cost-effective disaster risk financing strategy (DRFS).

Image Supplied by the Palau National Emergency Management Office

Figure 2: Risk Layering Based on Disaster Frequency and Severity and Relevance in Terms of the Disaster Phases



A 'risk layering approach' is the most cost-effective solution for financing disaster risk, as such a DRFS prioritises cheaper sources of funding for events of different severity, ensuring that the most expensive instruments are only used in exceptional circumstances. For example, the type of insurance that is offered by PCRIC may provide cost-effective cover against relatively extreme events, but it may be inefficient and costly to protect against low intensity and recurrent events. For such events, a dedicated contingency fund that 'retains' this lowest layer of risk may be a more appropriate solution. A country may also have access to a contingent credit facility, which is typically used for events of 'medium' severity as shown in Figure 2 above.

New Products in the Pipeline

Given the demand from PICs, PCRIC is also developing new products. Excess rainfall and drought products are currently being developed, with the former scheduled to be released before Season 11, which runs from November 2022 to October 2023. The release of the two new products is envisaged to increase the uptake of PCRICs products by other PICs who would view the products to be more attractive and relevant to the disasters and risks that they encounter. For example, the Republic of Marshall Islands (RMI), which is more vulnerable to drought than a TC.

Image supplied by RMI National Disaster Management Office

It is critical for PICs to thoroughly understand the value preposition of the insurance cover available under the respective products offered by PCRIC. All products correlates to the risk exposure that has material impact on PICs and for this, PCRIC has taken an agile and innovative approach to constantly revamp and expand the suite of insurance products tailored to the needs of client countries.

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