Contingency Fund (1/2)

Definition

Contingency funds or disaster reserve funds are an important part of an efficient risk-layering approach. They allow governments to retain risk as part of their budget but still set resources aside in advance to facilitate rapid response in case of a shock, with clear prearranged processes and procedures for how the funds can be used.

A fund can be established in different ways. In some countries, the reserve fund is just a contingency allocation in the budget with specific rules for how these funds will be used. In other countries, a disaster fund is established as a dedicated institution, either a government agency or a de facto semi-independent service agency. In both cases, a disaster fund aims to improve disaster outcomes by (i) ensuring effective access to sufficient resources for disaster response; and (ii) streamlining execution and transparency of spending.

Institutional arrangement of funds

The reserve fund can simply be a **contingency fund** in the budget with specific rules for its use OR

In other countries, an emergency fund is **set up as a dedicated institution**, either a government agency or a de facto semi-independent service agency

Depending on the government's financial capacity, it may decide to focus the fund either on **emergencies** or on **emergencies & reconstruction**

Generally, the fund is created by **decree** or by a **formal act**

Once the fund has been set up, **rules** or a **procedures manual are drawn up**, setting out how the fund operates in detail

Advantages

- Make funds immediately available, **providing rapid response** and recovery and minimizing the long-term impact of disasters
- Reduce **administrative delays**, as resources are already allocated to the fund
- Improve **transparency and accountability** in public spending
- Propose an **alternative or complementary offer to insurance**
- Reduce **dependence on debt financing** after a disaster
- Enable **inter-agency coordination** for the preparation, recovery and transfer of risks.

Disadvantages

- Involve the **opportunity cost of the existence of reserves** during the lull years between disasters
- Delays in **building up sufficient reserves** to cover disaster risks and in replenishing depleted funds.
- **Need for budget management and financial modelling** to ensure that funds and/or risk transfer capacity are sufficient to cover potential losses
- **Require processes, systems,** and **resources** necessary to ensure that funds are distributed effectively and transparently to the intended beneficiaries
- Can be mismanaged as reserves build up

Contingency Fund (2/2)

Example

The law establishing a Moroccan DRF Program was adopted by Parliament in August 2016 and entered into force on January 1st, 2020.

Financial mechanisms for allocating resources in advance to deal with potential disasters (natural and human) rely on a dual public-private system, the first of its kind. This dual scheme builds on market-based insurance and solidarity principles to protect insured and uninsured households against disasters.

DRF schemes

Insurance scheme

For policy holders (people and businesses)

Contingency fund

Solidarity scheme

For non-insured people

What & Who?

Solidarity fund provides uninsured people with compensation for:

- Permanent physical disability for bodily injury;
- To the owners of a residence rendered uninhabitable.
- Loss of resources to beneficiaries of deceased or missing victims;
- Loss of use of the main residence to tenants;

How?

The financial strategy of the fund:

- Fund reserve available to finance frequent shocks is based on accruing parafiscal tax (roughly US$20-25 million)
- Contingent loans up to US$ 80 m. mobilized in the event of a catastrophic event
- International risk transfer by insurance or the financial market (CAT Bonds) to cover the most expensive risks

Activation protocol