



# PCRAFI FACILITY: PHASE II

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

## BACKGROUND

On June 10, 2016, the PCRAFI Facility was established by legal statute in the Cook Islands. The Council of Members then developed the facility's governance structure and submitted an application to the Financial Supervisory Commission for a captive insurance license, which was issued on September 22, 2016. The facility can now play an incremental role in providing insurance coverage for the fifth season (November 1, 2016–October 31, 2017) of the PCRAFI insurance program.

The PCRAFI Facility provides the Pacific Island Countries (PICs) with climate- and disaster-related insurance in an effort to increase their financial resilience against climate and disaster risks. During the 2015 Forum Economic Ministers Meeting (FEMM) in the Cook Islands, the PICs agreed to establish the PCRAFI Facility, thus demonstrating their willingness to undertake management of the PCRAFI insurance program. The PCRAFI Facility provides parametric insurance solutions that increase PICs' financial response capacity and thus help them to meet post-disaster funding needs without compromising their fiscal balances and development. By giving PICs greater ownership of disaster and climate risk financing at the regional level, the facility gives them control and influence over the design of future disaster and climatic risk solutions.

Germany, Japan, the United Kingdom, and the United States have provided US\$40 million in grant funding toward the establishment of the PCRAFI Facility. During COP21, held in December 2015 in Paris, several donor partners pledged to support the development of the PCRAFI Program as part of the InsuResilience initiative championed by the G7. These efforts have now come to fruition.

The PCRAFI Program is supported by the PCRAFI Multi-Donor Trust Fund (MDTF) with the World Bank as trustee. In direct response to a request by the PICs at the 2015 FEMM, the World Bank collaborated with donor partners to secure funds and to establish the PCRAFI MDTF. See figure 1.

## PCRAFI PROGRAM

The PCRAFI Program has two core components:

- **PCRAFI Facility.** The facility has been established as an insurance captive and designed to provide the PICs with catastrophe risk insurance coverage on competitive terms.
- **PCRAFI Technical Assistance (TA) Program.** The TA Program provides the PICs, regional organizations, and the PCRAFI Facility with technical assistance and capacity building on disaster risk finance and insurance and on public financial management of natural disasters.

The PCRAFI Program is designed and operated according to 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 the long-term sustainability of the program requires regional ownership.
- (2) **Financial sustainability.** The PCRAFI Program, and especially the PCRAFI Facility, are 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 design 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) after a disaster. Such plans should be agreed to ex ante to avoid any delays in financing response in the aftermath of a disaster. Such plans should also give the PICs flexibility over the use of the insurance proceeds.
- (4) **Accountability and transparency.** To date the PCRAFI Program does not require accountability and transparency, but both Vanuatu and Tonga, which received insurance payouts, have been

transparent in their expenditures, providing detailed information on how the payouts were used. These principles will be further embedded by the ex post reporting requirements that the facility will develop in consultation with the PICs.

**(5) Comprehensive disaster risk financing strategy.** While catastrophe risk insurance helps to increase the 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.

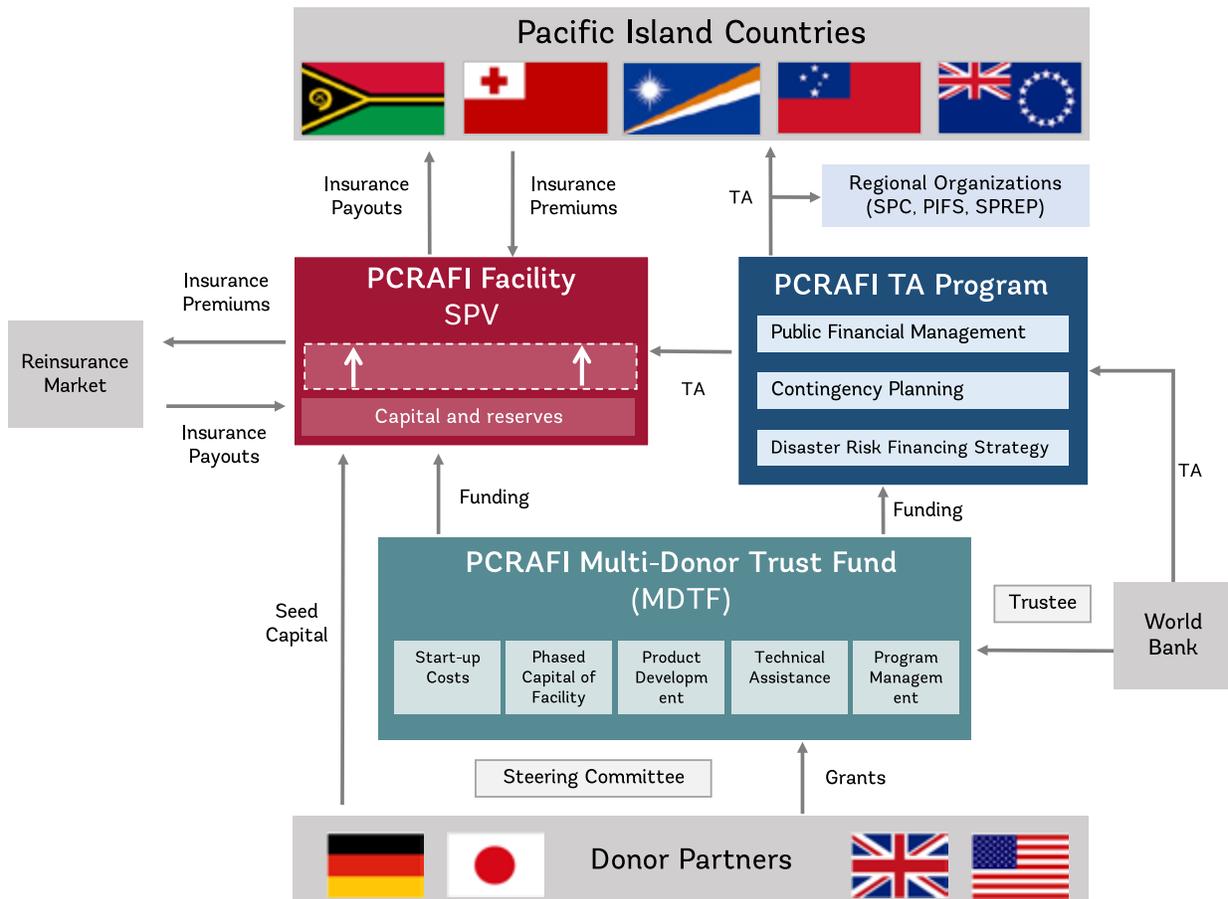
**(6) Link with disaster risk management agenda.** Disaster risk financing is part of the broader disaster risk management agenda, which aims to reduce the disaster risks faced by the PICs. The PCRAFI Program is executed in partnership with the Secretariat of the Pacific Community, which holds the regional 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 International Development Association (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 (Caribbean Catastrophe Risk Insurance Facility, CCRIF) and in Africa (African Risk Capacity, ARC), so there is an opportunity for knowledge exchange across the three regional institutions.

## PCRAFI FACILITY

The PCRAFI Facility provides insurance to the PICs in season five of the PCRAFI insurance program. This arrangement enables the phased handover of work for the PCRAFI insurance program from the World Bank to the facility, allowing it to build its capacity incrementally. It also ensures that the facility is operational for the implementation of the fifth season of insurance coverage, which starts on November 1, 2016.

FIGURE 1. PCRAFI PROGRAM



Note: SPV = special purpose vehicle; SPC = Secretariat of the Pacific Community; PIFS = Pacific Islands Forum Secretariat; SPREP = Secretariat of the Pacific Regional Environment Programme.

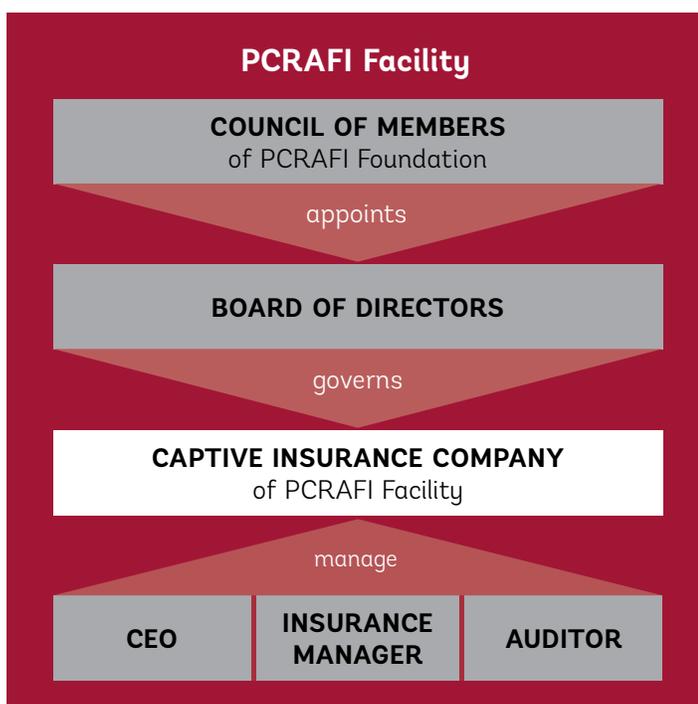
The Technical Working Group (TWG), composed of the secretaries of finance from the participating PICs, plays an instrumental role in developing the facility's governance arrangements. These arrangements are endorsed by both the participating countries and contributing donors in the inaugural meeting of the PCRAFI Council of Members. The facility has two overarching goals: (i) to increase the number of participating PICs; and (ii) to develop new disaster risk insurance products that address the needs of the PICs.

The PCRAFI Facility was established in the Cook Islands as a foundation with a board of directors that owns a group captive insurer. Established in the Pacific region, this structure ensures high ownership by the PICs. The Cook Islands were identified as the 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 type of oversight required to host a captive insurer. See figure 2.

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

The facility will receive US\$6 million in initial risk capital in its first year of operation from the PCRAFI MDTF. As the capacity of the facility grows over time, the capital requirements will also grow, and additional capital will need to be provided.

FIGURE 2. GOVERNANCE STRUCTURE OF PCRAFI FACILITY



## 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 organizations, and the ministries of finance of beneficiary PICs.

- **Technical assistance** to the PCRAFI Facility will support the establishment of the facility, help to build disaster risk insurance capacity, and assist in the development of new financial products. It will also facilitate technical collaboration (training sessions, workshops) and regular dialogue with similar regional facilities, in particular CCRIF and ARC.
- **Regional technical assistance** will be provided by the regional agencies of the Council of Regional Organizations of the Pacific; in addition, the expertise of the agencies—for example, in risk assessment (Secretariat of the Pacific Community and political dialogue (Pacific Islands Forum Secretariat)—will be leveraged.
- **National technical assistance** will be offered to the ministries of finance of the beneficiary countries in coordination with ministries responsible for disaster risk management; this approach ensures that the contingency plans of facility members are incorporated into their existing national frameworks via their disaster risk management policies, disaster risk financing strategies, and post-disaster budget execution guidelines. More specifically, this will involve (i) capacity building in post-disaster public financial management, including post-disaster budget execution, budget mobilization, and reporting on the development of disaster risk financing tools; (ii) the development of financial models to help assess the fiscal exposure to natural disasters; and (iii) the development and/or alignment of disaster risk financing strategies.

## ROLE OF DONOR PARTNERS

Donor partners play a critical role in the development of the PCRAFI Program and the establishment and capitalization of the PCRAFI Facility. Donor partners have supported the development of the PCRAFI insurance program since its inception (January 2013–October 2015) through the Pacific Disaster Risk Financing and Insurance MDTF and the Japan Disaster Risk Management single-donor trust fund held at the Global Facility for Disaster Reduction and Recovery (GFDRR). Donors will continue to play a critical role through (i) providing the PCRAFI MDTF with capital to support the establishment of the facility, (ii) supporting the incremental buildup of capital over its first years of operation, and (iii) providing financial support to the PCRAFI TA Program.

## NEXT STEPS

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**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, as countries like Fiji and the Federated States of Micronesia have expressed their interest in joining.

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

**Develop contingency plans and ex post reporting procedures in conjunction with PICs.** In order to create and shape national disaster risk financing strategies, the facility will work with PICs to develop contingency plans that ensure quick and efficient disbursement of funds after a disaster. These will be complemented by ex post financial reporting procedures designed to provide transparency on the use of funds and to ensure that reporting for statutory and regulatory purposes is met.

## HISTORY OF THE PCRAFI PROGRAM

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

**The PCRAFI insurance program is an example of a successful public-private partnership.** It has been piloted with five PICs: Vanuatu, Tonga, the Marshall Islands, Samoa, and the Cook Islands. 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 cofinancing of the insurance premiums during the first three years of operation. As of 2016, the PICs are paying their premiums 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 seven days of being affected by Tropical Cyclone Pam in March 2015.

### About PCRAFI

Phase II of the PCRAFI Program builds on the initial phase of the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI), a joint initiative of the World Bank, the Secretariat of the Pacific Community (SPC), and the Asian Development Bank (ADB), with financial support from the government of Japan, the Global Facility for Disaster Reduction and Recovery (GFDRR), and the European Union (EU). Launched in 2007, PCRAFI aims to build the financial resilience of Pacific Island Countries against natural disasters. Phase II of the program was launched in April 2016 and includes two key pillars: (i) the PCRAFI Facility, and (ii) the PCRAFI Technical Assistance Program.

### About the Pacific Resilience Plan (PREP)

To address the challenges posed by disaster and climatic hazards in the Pacific, the PREP consolidates the national and regional programs such as PCRAFI that have been undertaken by the World Bank to date. The PREP is 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 countries’ post-disaster response capacity 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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