

DEFINING THE PROTECTION GAP

Introduction

- In recent years, we've seen a considerable increase in disasters, both in their frequency and severity. Overall economic losses from such disasters currently average \$250 billion - \$300 billion a year¹. This has serious consequences in many countries, in limiting economic and social development.
- In many cases, urbanization is adding to this risk by concentrating populations and economic value. By 2030, six out of ten people will live in cities; according to the World Bank, cities already generate 80% of global GDP.
- It's clear that in many countries current measures do not go far enough to adequately protect people, property, services and vital infrastructure from the effect of disasters and extreme weather events. Nor do they currently encourage a better understanding of disaster risk, what drives it, or the risk reduction measures required.
- As a result, many local populations struggle to recover from disaster; there is also an increased financial burden on governments, NGOs and the donor community, as well as the private sector and individual households. Increases in headline figures for losses may underestimate the effect of disasters on the poorest and most vulnerable. In addition, as populations and economic activity in hazard-prone areas increase, new investment requirements will grow rapidly².
- There are few reliable figures on insured losses vs. total economic losses from catastrophes; those often quoted are approximately 50% in developed countries, 10% in emerging economies and 1% in Africa. These figures would suggest there is a very considerable protection gap.

1: Decide who /what should be protected:

Scenario planning /risk modelling:

- Determine who /what is at risk given specific event (flood, earthquake, tsunami, storms, extreme weather events, droughts, heatwaves etc.), its magnitude and frequency. If possible, systemic risk should be included in scenario modelling.
- Planning /modelling would provide the basis for comprehensive risk management approach and for determining first what – and how much – risk can be prevented or mitigated through targeted structural reforms (i.e. risk prevention /mitigation as well as risk transfer). Planning /modelling should also take into account, of course, the impact of recently-taken prevention /mitigation measures (such as investment in more resilient infrastructure /behaviour change programmes), which may reduce overall levels of risk and imply lower costs in certain areas following disaster.

¹ Despite reductions in mortality, expected average annual losses worldwide from earthquakes, tsunamis, tropical cyclones and river flooding are now estimated at \$314 billion in the built environment alone. Please see UNISDR Global Assessment Report on Disaster Risk Reduction (GAR15): http://www.preventionweb.net/english/hyogo/gar/2015/en/gar-pdf/GAR2015_EN.pdf.

² Required investment in urban infrastructure, for example, is already running at an estimated \$90 trillion up to 2030 (see Global Commission on the Economy & Climate, 2014; World Investment Report 2014 – WRI, UNCTAD).

Who

Vulnerable groups /populations (broadly speaking, those unable to protect themselves, or absorb the shock of disaster. In less developed economies, the size of this vulnerable population is likely to be larger, though it's clear sizable vulnerable populations may also exist within highly-developed economies).³

What

Direct costs as a result of disaster, comprising both:

- Private (homes, property, businesses etc.)
- Public (infrastructure, services, systems etc.)

In the case of governments /public, it's vital to consider systemic risk – the possibility that one risk event will trigger another (that a disaster may cause a breakdown in healthcare, for example, and result in a social /humanitarian crisis).

2: Mobilize available resources in event of disaster:

Given risk assessment, successful response to disaster depends to a large degree on:

- Available resources at the time of disaster (drawn from both private and public sources, as well as 'self-insurance')
- Ability to mobilize these resources in time (i.e. can resources be mobilized quickly enough to prevent longer-term economic or social dislocation?)
- Ability to use available resources effectively (i.e. are there adequate services available for effective recovery and reconstruction? This is an important issue – poor organization was a key factor in the international response to the Haiti earthquake in 2010).

Available resources include, firstly, 'self-insurance' – these are the losses that can be absorbed by an economic actor's own financial capacity (whether government, community, household or business). Such capacity among government is declining, with the result that there is more pressure on the capacity of businesses and individuals. At times, it is difficult, even for governments, to mobilize adequate resources – which leads to an issue of timing. Consequently, the protection gap will depend not only on the magnitude of any disaster, but also an ability to mobilize financial (and other resources) in good time.

Available resources may include the following:

- **Government** (cash, reserves, ability to raise debt on international money markets etc.)*
- **Support from donor community** (donor governments, NGOs, development banks etc.)
- **National /regional insurance programmes** ('sovereign' insurance programmes such as Africa Risk Capacity, US National Flood Insurance Program etc.)
- **Private insurance** (covering homes, SMEs and larger businesses, including life insurance for individuals and disaster cover for properties and businesses).

³ Please note that the Sendai Framework has a broader definition of 'vulnerability', which takes in social, health and economic aspects. Our intention, in this paper, however, is to focus on the immediate impact of disaster on vulnerable populations.

*Budget transfer – in the event of a disaster, governments may be required to re-allocate public resources from other budget lines; the opportunity cost of this may be significant, particularly in situations where public spending is already under pressure, or in countries with a high ratio of annual losses to social expenditure, capital investment and capital stock. In such cases, transferring spending may have implications for countries' ability to meet their sustainable development goals.

3: Options for insurance /risk transfer

For the remaining 'residual' risk, there are a number of options for insurance /risk transfer; these fall,

Contrasting examples of New Zealand & Haiti

Both suffered similar earthquakes in recent years (magnitudes of 7.1 and 7.0 respectively)

- **New Zealand:** much of the risk covered by insurance industry and NZ Earthquake Commission; most houses /properties repaired quickly. Loss of life was relatively limited (185)
- **Haiti:** reliance on external aid, which was slow in arriving; economic shock much greater; thousands of people still living in tents /temporary accommodation long after the event. Loss of life was very significant (up to 200,000).

broadly speaking into three categories:

'MICRO'	'MESO'	'MACRO'
Individual insurance policies (e.g. home insurance against natural hazards /micro-insurance in developing countries /insurance of SMEs and larger businesses).	National programs, usually government-supported. Examples include US National Flood Insurance Program, Turkey Catastrophe Insurance Pool.	Sovereign /regional programs. Examples include Caribbean Catastrophe Risk Insurance Facility (CCRIF), African Risk Capacity (ARC) etc.

Important that these options are considered as part of a **comprehensive risk approach**:

- It's clear there is interaction between options (the presence of an effective government protection programme, for example, may reduce demand for private insurance. By the same token, insurance needs to be priced in a way that incentivizes risk prevention /mitigation). A comprehensive risk approach will focus discussion on this interaction and highlight practical policy responses.
- Liabilities have increased in recent years (given the effects of climate change). Neither the government nor the private sector alone can cope with these increased liabilities; they must therefore work together. Governments have contingent liabilities that are either explicit or implicit (where the government is expected to act as 'insurer of last resort'). For their part, insurers are limited by their own capacity and unwillingness of regulators to allow insurers to take on too much additional risk.
- Insurance has a role beyond simple 'risk transfer'; generally, for buildings, infrastructure and other assets to be insurable, there need to be minimum standards. Ensuring compliance with these standards, if well designed, helps strengthen overall resilience (e.g. in construction codes that ensure buildings are resilient to extreme weather) – and can help identify points of weakness within broader systems (e.g. cities that inadvertently create 'corridors' that actually accelerate windspeeds during severe storms)

Ultimately, countries will choose a mix of risk transfer options, depending on a number of factors (inc. their level of economic development, political culture and history, objectives of the government etc.)

Example: in California, take-up of insurance (against earthquake risk) is relatively low, approximately 9%-10%; this is due to three principal factors: pricing, the low frequency nature of the event and 'moral hazard' (the assumption that, in the case of disaster, the government, through FEMA, will pay for damages and reconstruction).

Defining the protection gap /proposed indicators



Possible indicators to measure the protection gap

- #homes insured (vs. total #homes /total #insurable homes)
- #insurable homes (vs. total #homes /total #uninsurable homes)
- #uninsurable homes (vs. total #homes /#total insurable homes)
- #SMEs /MSMEs insured against disaster (vs. total # SMEs /MSMEs)
- #workers covered by unemployed benefit in event of disaster (vs #total eligible workforce /those in employment)
- #businesses providing unemployment insurance to employees in event of disaster (vs. total #businesses)
- #key infrastructure insured vs. total key infrastructure
- Sovereign credit rating /government cash or 'callable' reserves
- Existence of business continuity planning for key infrastructure /SMEs /larger businesses