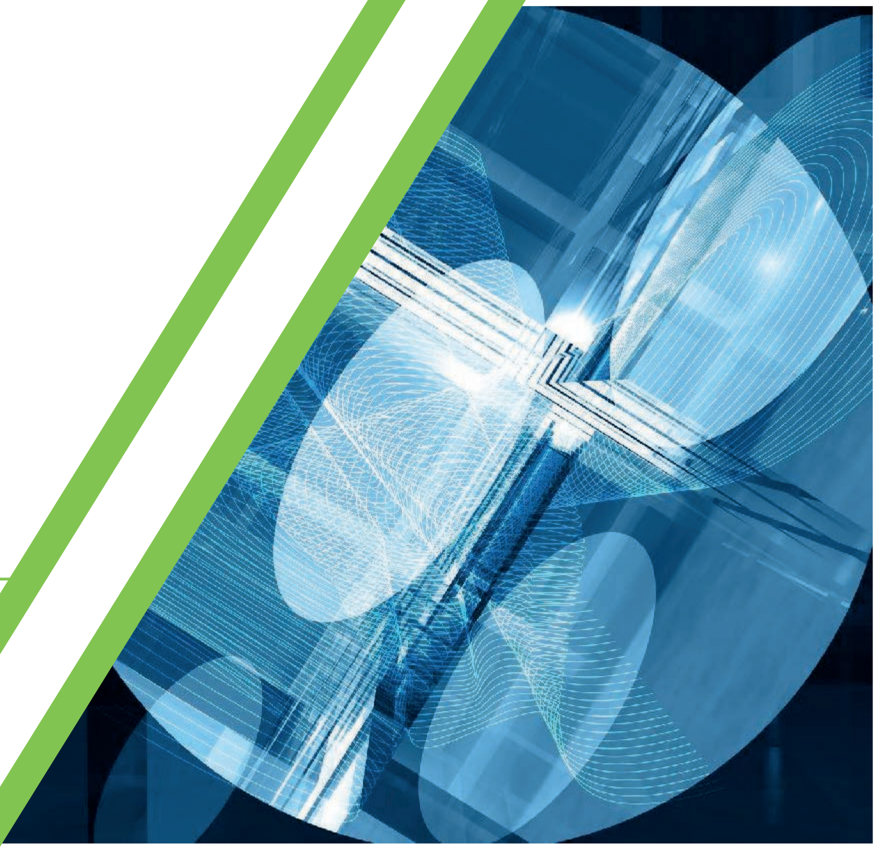
Recommendation of the Council on Disaster Risk Financing Strategies



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Background Information

The Recommendation on Disaster Risk Financing Strategies was adopted by the OECD Council on 23 February 2017 on the proposal of the Insurance and Private Pensions Committee. The Recommendation updates and replaces the 2010 OECD Recommendation on Good Practices for Mitigating and Financing Catastrophic Risks. It provides high-level policy guidance on the financial management of disaster risks, drawing on the lessons that have been learned through the OECD's work for the G20 and APEC Finance Ministers. It is aimed specifically at issues related to the financial management of disaster risks, yet recognises the importance of an integrated approach to disaster risk management and the contribution of risk assessment, risk awareness and risk prevention to the financial management of disaster risks. In that regard, it complements the 2014 OECD Recommendation on the Governance of Critical Risks, providing and integrated set of OECD guidance on disaster risk management and financing.

THE COUNCIL,

HAVING REGARD to Article 5b) of the Convention on the Organisation for the Economic Co-operation and Development of 14 December 1960;

HAVING REGARD to the Recommendation of the Council concerning Guidelines on Earthquake Safety in Schools [C(2005)24], the Recommendation of the Council on Good Practices for Enhanced Risk Awareness and Education on Insurance Issues [C(2008)22], the Recommendation of the Council on the Protection of Critical Information Infrastructures [C(2008)35], and the Recommendation of the Council on Digital Security Risk Management for Economic and Social Prosperity [C(2015)115];

CONSIDERING the development of legal instruments providing international guidance on the management of disaster risks since the adoption of the Recommendation of the Council on Good Practices for Mitigating and Financing Catastrophic Risks [C(2010)143/REV1], which this Recommendation replaces, and, in particular, the adoption of the Recommendation of the Council on the Governance of Critical Risks [C/MIN(2014)8/FINAL], which provides complementary guidance on the management of critical risks, including disaster risks;

RECOGNISING the significant social, economic and financial impact of disasters, both natural and man-made, and the potential for climate change to increase the frequency and intensity of extreme events, which combined with increases in the value of assets in locations exposed to hazards can be expected to lead to larger impacts in the future;

RECOGNISING that the costs associated with natural and man-made disasters need to be properly assessed and financially managed, and that this requires the proactive development and regular update by governments of an integrated disaster risk financing strategy to mitigate the financial, economic and social impacts of disasters, that takes into account differences in the allocation of responsibilities between different levels of government in different countries as well as complementary policy objectives, such as solidarity across countries/regions;

RECOGNISING that a disaster risk financing strategy is a central component of a comprehensive approach to disaster risk management and sustainable development and should be anchored in an integrated framework of hazard identification, risk and vulnerability assessment, risk awareness and education, risk management, and disaster response and resilient recovery;

RECOGNISING that, while risk transfer tools, such as (re)insurance and capital markets instruments, can play a fundamental role in reducing the economic impacts of disasters, the only sustainable way to reduce disaster impacts over time is through investments in risk reduction and building resilience against disaster risks;

NOTING that the OECD plays a leading role in supporting Members and Partners in managing the financial impacts of disasters, and that this work has been welcomed by international fora, such as in the Communiqué of the Meeting of G20 Finance Ministers and Central Bank Governors in Mexico City (2012) and the Asia-Pacific Economic Cooperation Finance Ministerial Meeting's Joint Ministerial Statement (2013);

NOTING that the effective financial management of disaster risks is critical for achieving the objectives of the Sendai Framework for Disaster Risk Reduction (2015) and the goals related to loss and damage included in the Paris Agreement on Climate Change (2015).

On the proposal of the Insurance and Private Pensions Committee:

I. AGREES that, for the purpose of the present Recommendation, the following definitions are used:

- "Disaster risks": a function of hazard, exposure, vulnerability and capacity, disaster risks are related to the potential for sudden or slow onset events with adverse consequences which are either natural or man-made (e.g. earthquakes, floods, large-scale cyber incidents, terrorist attacks), some of which should be considered critical risks;

- “Exposure”: a measurement of the value at risk of damage and loss;
- “Financial Protection”: in the context of disaster risks, the level of payment to be expected based on the occurrence of a disaster event and/or the specific costs incurred as a result of a disaster event (e.g. property insurance contract, parametric insurance contract, catastrophe bond, government compensation or financial assistance for disaster losses);
- “Financial Vulnerability”: a vulnerability that results from a gap between exposure to damage and loss and the financial capacity to absorb those damages and losses;
- “Public (re)insurance”: insurance or reinsurance provided by the public sector;
- “Risk assessment”: a methodology to determine the nature and extent of risk by both analysing hazards and their potential likelihood and intensity and estimating impacts through the evaluation of conditions of vulnerability and the identification of exposed people, property, infrastructure, services, livelihoods and their environment;
- “Risk retention”: an approach to risk management that involves retaining responsibility for the risk and any costs associated with the materialisation of that risk; and
- “Risk transfer (tool)”: an approach to risk management that involves the transfer of financial responsibility for some or all of the risk and any costs associated with the materialisation of that risk (e.g. through a financial instrument such as property insurance contract).

II. **RECOMMENDS** that Members and non-Members having adhered to the Recommendation (hereafter “the Adherents”) **establish a strategy, under the leadership of Ministers of Finance or other relevant national authority, for managing the financial impacts of disasters**, appropriately respecting differences in the level of national responsibility for disaster risks in different countries, that:

i) Fosters, by implementing the elements of this Recommendation, an integrated approach to the financial management of disaster risks across all levels of government, built on a sound foundation of risk management, which includes a comprehensive, multi-hazard risk assessment, aimed at maximising the overall cost-effectiveness of public and private investment.

ii) Provides the resources necessary to ensure sufficient institutional capacity and expertise for the assessment of disaster risks and the relative costs and benefits of different approaches to managing those risks.

iii) Ensures co-operation and co-ordination across organisations in the public and private sectors, including different levels of government, with responsibilities for, and expertise in, managing the financial impacts of disaster risks and, where relevant, leverages opportunities for international co-operation and information sharing, recognising the potential cross-border drivers and impacts of disaster risks.

iv) Assesses the appropriate levels of risk retention and risk transfer, taking into account the responsibilities and accountabilities for the financial impacts of disaster risks across the public and private sectors, including different levels of government, and their capacity to manage those financial impacts; and identifies any financial vulnerabilities as a result of exposure to disaster risks.

III. **RECOMMENDS** that Adherents **promote comprehensive risk assessment processes** that allow for the estimation of exposures and the identification of financial vulnerabilities by:

i) Promoting the development of technologies and expertise in monitoring and assessing disaster risks by government, the private sector and non-governmental organisations, including the scientific and academic communities and, where beneficial, by taking advantage of private sector capability and expertise in the development of risk assessment and exposure models.

ii) Ensuring that data on assets, structural vulnerabilities, hazards and past losses necessary for the quantification of potential exposures is produced, collected, shared and made publicly available, subject to applicable confidentiality and privacy requirements. Efforts to harmonise the collection and reporting of data nationally, regionally and internationally should be made. Post-disaster loss assessments should be completed for significant events, undertaken based on a consistent methodology and co-ordinated with the private sector, in order to support the availability of data necessary for evaluating exposures to disaster risk going forward.

iii) Taking into account both direct and indirect impacts, evaluating both normal and extreme scenarios, anticipating any significant changes in the nature of risk (e.g., as a result of climate change), and accounting for the level of uncertainty inherent in such estimates as well as sectoral, regional and international interdependencies.

IV. **RECOMMENDS** that Adherents **support the effective management of the financial impacts of disasters** by all segments of the population and economy and encourage the development of risk transfer markets for disaster risks, by:

i) Supporting initiatives to raise individuals', businesses' and, where applicable, subnational governments' awareness of disaster risks, their responsibility for managing those risks, and the scope of financial protection provided by financial institutions and public entities. Information on disaster risks and the scope of financial protection should take into account the behavioural biases of individuals and groups, such as the tendency to underestimate risk as well as the level of financial literacy and inclusion.

ii) Implementing a financial sector regulatory and supervisory framework that:

   a) Ensures a sound, open and efficient financial sector with sufficient financial capacity to absorb disaster risks, including by enabling the use of risk transfer to national and international (re)insurance and capital markets.

   b) Enables pricing, contractual terms and conditions (e.g. premiums, deductibles, coverage limits, co-share, excess of loss) that facilitate risk transfer while encouraging risk reduction.

   c) Requires the use of contractual terms on the scope of financial protection and any exclusions or limitations that are understandable to non-experts.

   d) Ensures that the necessary plans, processes and operational capacity are in place to provide timely and fair payment of claims resulting from insured disaster damages and losses, including, where relevant, time limits for making advance payments on claims incurred.

iii) Evaluating measures to address any challenges to the availability and/or affordability of risk transfer tools for all or certain disaster risks, such as:

   a) Effective land-use and building standards and making targeted investments in prevention;

   b) Regulatory requirements related to the purchase or offer of risk transfer tools;

   c) Financial incentives for private investment in risk reduction; and

   d) Public (re)insurance arrangements and guarantees, which can support the broad availability and affordability of risk transfer tools.

iv) Where necessary, developing public compensation and financial assistance arrangements, co-ordinated across levels of government, to provide timely, targeted, transparent and equitable assistance for uninsurable losses to vulnerable segments of the population and/or economy and financial transfer mechanisms to provide support to sub-national levels of government facing fiscal constraints, with the aim of minimising economic disruptions and facilitating a stable supply of financing to the economy.

v) Ensuring that disaster insurance and compensation arrangements encourage public and private risk reduction and recognise the benefits of utilising the capacity of national and international (re)insurance and capital markets to absorb disaster losses.

V. **RECOMMENDS** that Adherents effectively **manage the financial impacts of disasters on public finances** by:

i) Evaluating the potential financial exposures of government to disaster risks, taking into account, where applicable:

a) The expected costs of relief and recovery as well as reconstruction of public infrastructure;

b) Exposures to losses as a result of public (re)insurance arrangements or guarantees;

c) Estimated payments under public compensation and financial assistance arrangements to segments of society and the economy that are vulnerable to disaster risks and/or sub-national levels of government facing fiscal constraints, including the possibility of unanticipated financial assistance; and

d) The potential impact of a deterioration in macro-economic conditions, such as a decline in economic activity, government revenues or a deterioration in the balance of payments.

ii) Developing an ex ante plan or plans for managing the financial impacts of disasters on public finances, considering the potential contribution of budget reallocations, temporary taxation, debt financing, reserves, insurance, and capital market instruments, taking into account financial capacity, desired risk retention and transfer levels, as well as the cost, timing and availability of the various financing options.

iii) Publicly disclosing, where permissible, that plan or plans (or portions thereof) with the aim of building confidence in the government's capacity to manage the financial impacts of disasters.

iv) Assessing the benefit of risk retention or risk transfer relative to ex ante investments in risk prevention, taking into account appropriate discount rates.

VI. **INVITES** the Secretary-General to disseminate this Recommendation;

VII. **INVITES** Adherents to disseminate this Recommendation at all levels of government;

VIII. **INVITES** non-Adherents to take into account and adhere to this Recommendation;

IX. **INSTRUCTS** the Insurance and Private Pensions Committee to monitor the implementation of this Recommendation and to report thereon to the Council no later than five years from its adoption and regularly thereafter.

Adherents*

OECD Members	Non-Members
Australia	
Austria	
Belgium	
Canada	
Chile	
Czech Republic	
Denmark	
Estonia	
Finland	
France	
Germany	
Greece	
Hungary	
Iceland	
Ireland	
Israel	
Italy	
Japan	
Korea	
Latvia	
Luxembourg	
Mexico	
Netherlands	
New Zealand	
Norway	
Poland	
Portugal	
Slovak Republic	
Slovenia	
Spain	
Sweden	
Switzerland	
Turkey	
United Kingdom	
United States	

*Additional information and statements are available in the Compendium of OECD Legal Instruments: http://legalinstruments.oecd.org

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The OECD Member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Legal Instruments

Since the creation of the OECD in 1961, around 450 substantive legal instruments have been developed within its framework. These include OECD Acts (i.e. the Decisions and Recommendations adopted by the OECD Council in accordance with the OECD Convention) and other legal instruments developed within the OECD framework (e.g. Declarations, international agreements).

All substantive OECD legal instruments, whether in force or abrogated, are listed in the online Compendium of OECD Legal Instruments. They are presented in five categories:

- **Decisions**: OECD legal instruments which are legally binding on all Members except those which abstain at the time of adoption. While they are not international treaties, they entail the same kind of legal obligations. Adherents are obliged to implement Decisions and must take the measures necessary for such implementation.

- **Recommendations**: OECD legal instruments which are not legally binding but practice accords them great moral force as representing the political will of Adherents. There is an expectation that Adherents will do their utmost to fully implement a Recommendation. Thus, Members which do not intend to do so usually abstain when a Recommendation is adopted, although this is not required in legal terms.

- **Declarations**: OECD legal instruments which are prepared within the Organisation, generally within a subsidiary body. They usually set general principles or long-term goals, have a solemn character and are usually adopted at Ministerial meetings of the Council or of committees of the Organisation.

- **International Agreements**: OECD legal instruments negotiated and concluded within the framework of the Organisation. They are legally binding on the Parties.

- **Arrangement, Understanding and Others**: several ad hoc substantive legal instruments have been developed within the OECD framework over time, such as the Arrangement on Officially Supported Export Credits, the International Understanding on Maritime Transport Principles and the Development Assistance Committee (DAC) Recommendations.