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Draft Recommendation on Building Financial Resilience to Disaster Risks

Capital Markets and Financial Institutions Division
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Paris, France

Background

PURPOSE OF THE PUBLIC CONSULTATION

The purpose of this consultation is to seek comments and feedback on proposed draft revisions to update the Recommendation on Disaster Risk Financing Strategies [OECD/LEGAL/0436], including a potential change to its title to Recommendation on Building Financial Resilience to Disaster Risks. The proposed revisions to the Recommendation have been developed by the OECD Insurance and Private Pensions Committee ("IPPC") and reflect the findings and conclusions of the 2022 Report to the OECD Council on the Implementation of the Recommendation [C(2022)166/REV1].

HAVE YOUR SAY

The IPPC is now inviting interested stakeholders to comment on a consultation draft of the Recommendation. The public consultation is open to all interested stakeholders from all countries, including businesses, industry groups, civil society organisations, trade unions, as well as academia, interested citizens, international organisations and governmental experts (including from non-Adherent countries). The Recommendation and therefore the current revision process is likely to be of particular interest to relevant policy makers and public authorities, insurance industry representatives and consumer representatives.

Please submit your comments by email addressed to Leigh Wolfrom (leigh.wolfrom@oecd.org).

The public consultation is **open until 19 May 2023**.

Comments may be submitted in English or French. You will not receive an individual response to your input unless the OECD Secretariat needs to clarify your feedback. Responses received will be analysed by the OECD Secretariat and shared with the IPPC. They will be taken into consideration in developing the final version of the draft Recommendation on Building Financial Resilience to Disaster Risks. The final draft revised Recommendation will be submitted to the IPPC for approval and transmission to the OECD Council for adoption. A summary of responses will be published on the website in an aggregated and anonymised format. Please indicate clearly if you do not wish your response to be included in the published summary.

Any questions can be addressed to leigh.wolfrom@oecd.org.

YOUR DATA PROTECTION RIGHTS

Any personal data you provide as part of this consultation, including your name and responses, will be protected consistent with the OECD Data Protection Rules. Under the Rules, you have rights to access and rectify your personal data, as well as to object to its processing and request erasure in certain circumstances. To exercise these rights in connection with the consultation, please contact leigh.wolfrom@oecd.org. If you have further queries or complaints related to the processing of your personal data, please contact the Data Protection Officer. If you need further assistance in resolving claims related to personal data protection you can contact the Data Protection Commissioner.

RECOMMENDATION ON BUILDING FINANCIAL RESILIENCE TO DISASTER RISKS

The effective financial management of disaster risks is a key public policy challenge for governments around the world, particularly those faced with significant exposures to such risks and/or limited capacity to manage the resulting impacts. Disasters generate a broad range of direct and indirect impacts on all parts of society, including loss of life and livelihoods and damage and disruption to public and private property and infrastructure as well as fiscal impacts arising from recovery and reconstruction expenditures and decreased tax revenues.

The draft *Recommendation on Building Financial Resilience to Disaster Risks* aims to provide guidance on the financial management of disaster risks. It includes a set of high-level recommendations for addressing the financial impacts of disasters, comprising four building blocks:

- Ensuring comprehensive risk assessment by supporting the availability of data and technology necessary for the quantification of disaster risks and the identification of potential financial vulnerabilities - serving as the basis for making effective decisions on risk management and underwriting insurance coverage for these perils;
- Supporting the effective management of financial impacts, by building up a financial system and regulatory frameworks necessary to support the ability and willingness of individuals, businesses and sub-national governments to protect themselves against the financial impacts of disaster risks, with measures to support risk awareness, risk reduction and the availability of affordable insurance and other financial protection tools;
- Effectively managing the impacts of disasters on public finances by evaluating the potential financial impacts and risks to public finances and developing an approach to ensure adequate funding to respond to financial demands; and,
- Establishing strategies for managing the financial impacts of disasters, based on an integrated, multi-hazard approach and cooperation across levels of government and with relevant stakeholders, supported by the necessary resources and expertise.

The draft revised Recommendation aims to provide guidance that is relevant for a wide range of countries facing different levels of disaster risk and capacities to manage those risks and to contribute to efforts to build financial resilience at the G7, G20, APEC and other international fora.

This draft revised Recommendation would update (and replace) the 2017 Recommendation on Disaster Risk Financing Strategies [OECD/LEGAL/0436].

UPDATES TO THE RECOMMENDATION

In 2022, the OECD Insurance and Private Pensions Committee undertook a review of the implementation of the *OECD Recommendation on Disaster Risk Financing Strategies*. The 2022 Report to the OECD Council on the Implementation of the Recommendation concluded that the Recommendation remains relevant for efforts to build financial resilience against disaster risks. It was noted that the economic and social impacts of natural hazards and other types of large-scale disasters have continued to increase. For example, a changing climate has been linked to an increase in the frequency and/or severity of many types of climate-related hazards, including floods and cyclones. At the same time, increasing reliance on digital technologies has led to greater exposure to cyber attacks and a number of incidents have demonstrated the potential for widespread or even systemic consequences due to common exposures to key information technology infrastructure such as cloud services and operating systems. The COVID-19 pandemic illustrated the potential economic and social vulnerabilities that can result from a large-scale infectious disease outbreak exacerbated by a significant gap in insurance market coverage that led to a need for large-scale fiscal support for impacted individuals and businesses.

This recent experience highlights the continued need for governments to ensure that they are prepared to address the financial consequences of all types of disaster risks. It also highlights the importance of ensuring that the Recommendation's guidance properly captures the different measures that may be necessary to address the financial impacts of disasters such as cyber attacks and infectious disease outbreaks. In this context, a need to better reflect these types of risks in the content of the Recommendation was identified. In addition, in an effort to streamline the set of OECD legal instruments related to the financial management of terrorism risk, relevant elements of the *Recommendation on the Establishment of a Check-List of Criteria to define Terrorism for the Purpose of Compensation* [OECD/LEGAL/0331] have been incorporated into this draft revision.[1]

SUMMARY OF PROPOSED DRAFT REVISIONS TO THE RECOMMENDATION

The proposed draft revisions to the Recommendation are aimed at: (i) ensuring that the content of the Recommendation addresses increasingly important emerging and (re)emerging risks such as large-scale cyber attacks and infectious disease outbreaks and the relevant risk reduction and response mechanisms for such risks; and (ii) streamlining the set of legal instruments under the responsibility of the IPPC by incorporating relevant elements of the Recommendation on the Establishment of a Check-List of Criteria to define Terrorism for the Purpose of Compensation.

The main proposed revisions include:

- A change to the title to "Recommendation on Building Financial Resilience to Disaster Risks" as a means for better communicating the objective of the Recommendation and inclusion of a new definition of "financial resilience".
- Changes to some definitions to ensure consistency with terminology as recommended in the *Report of the open-ended intergovernmental expert working group on indicators and terminology relating to disaster risk reduction*.
- Inclusion of a new definition of – and references to – "risk management standards and measures" to better incorporate different types of risk reduction mechanisms, including for risks such as large-scale cyber attacks and infectious disease outbreaks.
- Inclusion of a new definition of – and references to – "risk financing tools" to better incorporate risk financing (e.g., lending) as a form of financial protection, based on the experience in responding to COVID-19. In addition, some provisions would be revised to better incorporate risk financing as a relevant source of funding to address disaster impacts.
- Inclusion of a new definition of – and references to – "public compensation and financial assistance arrangements" to address a gap in definitions in the Recommendation and better incorporate the role of public financial assistance to address financial vulnerabilities, particularly in light of the COVID-19 response. In addition, some provisions would be revised to better incorporate public compensation and financial assistance arrangements as a relevant source of funding to address disaster impacts.
- Inclusion of a new definition of – and references to – "disaster risk reduction" to address a gap in definitions in the Recommendation and better highlight the importance of disaster risk reduction as a relevant approach to financial management.
- Inclusion of a new definition of – and references to – "uninsurable losses" to incorporate the relevant concept from the *Recommendation on the Establishment of a Check-List of Criteria to define Terrorism for the Purpose of Compensation* and support guidance on public compensation and financial assistance arrangements.
- A revised definition of – and references to – "catastrophe risk insurance programmes" to replace the definition and references to "public (re)insurance" which did not accurately capture all forms of loss-sharing arrangements.
- Some streamlining of the existing text to provide greater clarity on specific issues, such as responsibilities across levels of government and within national governments as well as more focused headings for each of the components of strategies for building financial resilience.
- A slight restructuring of the provisions to include the set of general principles for the development of strategies for building financial resilience at the end. This allows for the inclusion of some new principles relevant to the characteristics and potential evolutions related to specific types of hazard based on the IPPC's work on climate-related natural disaster risk, cyber risk and pandemic risk as well

[1] The *Recommendation on the Establishment of a Check-List of Criteria to define Terrorism for the Purpose of Compensation* (2004) provides similar (although more detailed) guidance on elements related to the financial management of terrorism risk, specifically in terms of when government financial support for the availability of affordable insurance coverage may be necessary to address insurability challenges that emerge for any type of disaster risk.

as the integration of the *Recommendation on the Establishment of a Check-List of Criteria to define Terrorism for the Purpose of Compensation*, and with reference to the earlier parts of the Recommendation.

- Revisions to improve the clarity of guidance related to the identification of financial vulnerabilities and the management of disaster impacts on public finances, consistent with the findings of the 2022 Report. This includes revisions that reflect recent OECD work on the addressing climate-related risks to public finances (see *Building financial resilience to climate impacts: A framework for government action to manage the risks of losses and damages*).

CONSULTATION TEXT OF THE DRAFT RECOMMENDATION

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 standards developed by the OECD in the area of earthquake safety in schools, water, digital security, financial literacy, financial consumer protection, budgetary governance, governance of critical risks and insurance claim management;

CONSIDERING the OECD's international leadership in developing analysis and guidance on managing the financial impacts of disaster risks and building financial resilience and that this work has been welcomed by international fora;

RECOGNISING the significant financial, economic, social and environmental impacts of disasters, arising from hazards of both natural and human-made origin, and the potential for climate change to increase the frequency and/or intensity of climate-related events, which if combined with continued increases in the value of assets in locations exposed to climate-related hazards, can be expected to lead to larger impacts in the future;

RECOGNISING that the potential costs resulting from disasters need to be properly assessed and financially managed, and that this requires the proactive development and regular update by governments of integrated strategies to mitigate the financial, economic, social and environmental impacts of disasters, that take into account differences in the allocation of responsibilities between different levels of government across different countries as well as complementary policy objectives, such as solidarity across countries/regions;

RECOGNISING that strategies for building financial resilience to disaster risks are 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 response and resilient recovery;

RECOGNISING that, while risk transfer and risk financing tools as well as public compensation and financial assistance arrangements can play a fundamental role in reducing the financial, economic, social and environmental impacts of disasters, the only sustainable way to reduce disaster impacts over time is through investments in risk reduction and mitigation, climate adaptation and building resilience against these risks;

NOTING that building financial resilience to disaster risks is critical for achieving the objectives of the Sendai Framework for Disaster Risk Reduction (2015), the goals related to loss and damage included in the Paris Agreement on Climate Change (2015) and resilience objectives in the 2030 Agenda for Sustainable Development;

CONSIDERING that addressing the financial implications of disaster risks is a responsibility shared by national and subnational levels of government and that accordingly this Recommendation is relevant at all such levels, in accordance with legal, policy and institutional frameworks.

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:

- "Catastrophe risk insurance programme": an arrangement established by the insurance sector and/or government to provide insurance, co-insurance, reinsurance and/or a government guarantee for specific disaster risks;
- "Disaster": a serious disruption of the functioning of a community or a society at any scale due to hazardous events interacting with conditions of exposure, vulnerability and capacity,

leading to one or more of the following: human, material, economic and environmental losses and impacts;

·“Disaster risks”: the potential loss of life, injury, or destroyed or damaged assets which could occur to a system, society or a community in a specific period of time, determined as a function of hazard, exposure, vulnerability and capacity;

·“Disaster risk assessment”: A qualitative or quantitative approach to determine the nature and extent of disaster risk by analysing potential hazards and evaluating existing conditions of exposure and vulnerability that together could harm people, property, services, livelihoods and the environment on which they depend;

·“Disaster risk reduction”: Disaster risk reduction is aimed at preventing new and reducing existing disaster risk and managing residual risk, all of which contribute to strengthening resilience and therefore to the achievement of sustainable development;

·“Financial protection”: the sources of funding available to those impacted by a disaster to recover;

·“Financial Resilience”: the ability of a household, business, non-profit institution or government to recover without significant financial disruption or hardship from the damages and/or losses resulting from a disaster;

·“Financial Vulnerability”: a vulnerability that results from a gap between the risk of damage and loss and the financial capacity to absorb those damages and losses;

·“Public compensation and financial assistance arrangements”: an arrangement to provide government funding or a publicly-funded grant, loan, loan guarantee or other type of funding or guarantee to those impacted by a disaster;

·“Risk financing (tool)”: an approach to risk management that involves accessing financing to provide funding for some or all of the costs associated with the materialisation of the risk (e.g. through a financial instrument such as a loan or debt security);

·“Risk management standards and measures”: refers to the full range of standards and guidance, developed by governments or other organisations, public or private, for the purposes of reducing exposure and/or vulnerability to risk, such as land-use planning, building codes, physical, safety or digital security standards, protocols or frameworks;

·“Risk retention”: an approach to risk management that involves retaining responsibility for the financial costs associated with the materialisation of that risk;

·“Risk transfer (tool)”: an approach to risk management that involves the transfer of responsibility for some or all of the financial costs associated with the materialisation of that risk (e.g. through a financial instrument such as a property insurance contract); and

- “Uninsurable losses”: damages and losses that cannot be covered through insurance or for which no affordable insurance coverage is available, which may occur if the risk does not meet some of the requirements for technical, economic or legal/regulatory insurability (e.g. assessability, randomness, mutuality, loss magnitude, scope for diversification).

II. RECOMMENDS that Members and non-Members having adhered to the Recommendation (hereafter “the Adherents”) **promote comprehensive disaster risk assessments** to support the evaluation of financial impacts across the economy and population ~~that~~ and allow for the identification of financial vulnerabilities by:

i) Leveraging comprehensive, multi-hazard risk assessments that take 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.

ii) 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 capabilities and expertise in the development of disaster risk assessment and exposure models.

iii) Ensuring that data necessary for the quantification of potential disaster impacts are produced, collected, shared and made publicly available, subject to applicable confidentiality and privacy requirements. This should include data on hazards, the exposure and vulnerability of assets, eco-systems and populations, as well data as on past losses. Efforts to harmonise the collection and reporting of data nationally, regionally and internationally, should be made. Post-disaster loss assessments should be conducted 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 assessing disaster risks going forward.

iv) Assessing financial capacities to manage the financial impacts of disasters, taking into account responsibilities for managing these risks across the public and private sectors, including different levels of government, and the availability and use of risk financing and risk transfer tools, with the aim of identifying any potential financial vulnerabilities that may emerge as a result of disaster risks.

III.RECOMMENDS that Adherents **support the financial resilience of households, businesses, non-profit institutions and subnational governments to disaster risks** and the availability and use of risk transfer and risk financing tools for disaster risks, by:

i) Supporting initiatives to raise individuals', businesses', non-profit institutions' and, where applicable, subnational governments' awareness of disaster risks, their responsibility for managing those risks, and the availability of risk financing and risk transfer tools provided by insurers, other financial institutions such as banks, and public entities. Information on disaster risks and the availability 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) Ensuring the implementation of a financial sector regulatory and supervisory framework that:

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

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

c) Enables pricing, contractual terms and conditions (e.g. premiums, deductibles, coverage limits) that encourage risk reduction where relevant and as appropriate.

d) Facilitates the use of new technologies for disaster risk assessment, risk reduction and financial product innovation, while ensuring that consumers are appropriately protected.

e) Ensures that the necessary plans, processes and operational capacity are in place to provide timely and fair provision of funds, including the payment of insurance claims, to support efficient response, recovery, rehabilitation and/or reconstruction from disasters.

iii) Considering public and private measures to address any challenges to the availability and/or affordability of risk transfer or risk financing tools and the existence or emergence of financial vulnerabilities for all or certain disaster risks, such as:

a) Effective risk management standards and measures and targeted investments in risk reduction;

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

c) Inclusive and quality financial products that can mitigate disaster impacts;

d) Financial incentives or other mechanisms to support private investment in risk reduction; and,

e) Catastrophe risk insurance programmes, 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 and financial transfer mechanisms to provide support to sub-national levels of government facing fiscal constraints, with the aim of minimising economic disruptions and supporting recovery and future resilience.

v) Ensuring that catastrophe risk insurance programmes and public compensation and financial assistance arrangements, where established, encourage public and private risk reduction as appropriate, recognise the benefits of utilising the capacity of national and international banking, (re)insurance and capital markets to provide financial protection, and minimise the risk of moral hazard.

IV. RECOMMENDS that Adherents effectively **assess and manage the financial impacts of disasters on public finances,** by:

i) Evaluating the potential financial impacts of disasters on government, taking into account, where applicable:

a) The expected costs of relief and recovery as well as of reconstruction and rehabilitation of assets, economic and social infrastructure and eco-systems under public responsibility;

b) Exposures to losses as a result of funds invested into or (re)insurance or guarantees provided to catastrophe risk insurance programmes;

c) Estimated payments under public compensation and~~/or~~ financial assistance arrangements and fiscal transfers to households, businesses, non-profit institutions and/or sub-national levels of government facing financial vulnerabilities or fiscal constraints, taking into account the level of financial protection;

d) Possible unanticipated demands or needs for financial assistance; and

e) 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, as necessary, to ensure adequate funding to address the impacts of disasters on public finances, including public funding, along with risk financing (e.g. debt financing, contingent credit) and/or risk transfer tools (e.g. insurance, catastrophe bonds), taking into account fiscal and borrowing capacities as well as the cost, timing and availability of the various funding sources.

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 cost and benefit of risk retention or risk transfer relative to ex ante public investments in risk reduction.

V. RECOMMENDS that Adherents **establish coherent strategies for building financial resilience to disasters**, that:

i) Foster an integrated approach to managing the financial impacts of disaster risks across all levels of government, which appropriately respects differences in responsibilities and governance arrangements for managing disaster risks, and involves ministries and agencies with responsibility for risk assessment, risk reduction, critical infrastructure services, financial sector regulation and the management of public finances, among others.

ii) Provide the resources necessary to ensure sufficient institutional capacity and expertise for the implementation of these strategies.

iii) Ensure co-operation and co-ordination across organisations in the public and private sectors with responsibilities for, and expertise in, managing the financial impacts of disaster risks.

iv) Leverage, where relevant, opportunities for international co-operation and information sharing, recognising the potential cross-border drivers and impacts of disaster risks.

v) Take into account the characteristics, evolution and implications of different types of hazards, which may require additional measures to address potential limitations in the use, availability and/or affordability of risk transfer and/or risk financing, including but not limited to:

a) the potential for climate change to increase the frequency and/or severity of climate-related natural disaster events;

b) the impacts of digitalisation on the frequency and/or severity of cyber events, including the potential for accumulation risk;

c) the implications of social and political tensions for the frequency and/or severity of terrorism attacks, including cyber-terrorism attacks; and

d) the potential for environmental damage, habitat encroachment as well as other human actions to increase the frequency and/or severity of infectious disease outbreaks, including global pandemics resulting in highly-correlated losses across regions.

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

VII. INVITES Adherents to disseminate this Recommendation at all levels of government and to relevant domestic stakeholders;

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

IX. INSTRUCTS the Insurance and Private Pensions Committee to:

i) Serve as a forum for exchanging information, including experience with the implementation of this Recommendation;

ii) Develop tools to support the implementation of this Recommendation; and

iii) Report to the Council on the implementation, dissemination and continued relevance of this Recommendation every ten years following its revision.