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Risk transfer mechanisms:

Charting a strategy on local insurance[1]

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The Climate Change Act of 2009 (Republic Act (RA) 9729, as amended by RA 10174) and the Philippine Disaster Risk Reduction and Management Act of 2010 (RA 10121) mandate the creation of an enabling environment for the development of risk transfer mechanisms (RTMs) to guarantee social protection and resiliency in the aftermath of disasters.[4] After nearly a decade since these laws were enacted, policy developments on the creation of an enabling environment for risk transfer have remained only at the national level.[5] While policy goals and objectives on risk transfer have been articulated in our laws and translated into national plans, policy implementation at the local level still remains a challenge.

Understanding risk transfer

In the aftermath of disasters, the burden of financing recovery is usually shouldered by the government. The usual sources of disaster risk financing are public funds. When these funds are used by the government for disaster risk financing, risk retention ensues. Thus, *risk retention* is defined as the "process in which a party holds on to the financial responsibility for loss in the event of a shock" (Mahul and Stutley 2010, xxv). RA 10121, on the other hand, defines *risk transfer* as "the process of formally or informally shifting the financial consequences of particular risks from one party to another whereby a household, community, enterprise or state authority will obtain resources from the other party after a disaster occurs, in exchange for ongoing or compensatory social or financial benefits provided to that other party" (Section 3(kk)). Hence, in this mode, the burden of financing is shifted or transferred to the private sector or the market. Another way of looking at it is that risk retention comes from internal and public sources, while risk transfer entails external and non-public or private sources.

The World Bank created the Disaster Risk Financing and Insurance Program (DRFIP) to assist countries in crafting and implementing post-disaster

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[1] This policy brief is based on the authors' paper of the same title which is part of the research project "A Study on the Implications of Federalism in the National Capital Region and Considerations for Forming the Federal Administrative Region" of the University of the Philippines Center for Integrative and Development Studies (UP CIDS), the Department of the Interior and Local Government–National Capital Region (DILG–NCR), and the Local Government of Quezon City. The project is funded by the DILG–NCR.

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[4] Section 9(g) of RA 9729 mandates the Climate Change Commission (CCC) to "create an enabling environment for the design of relevant and appropriate risk sharing and risk transfer instruments, while Section 6(f) of RA 10121 mandates the National Disaster Risk Reduction and Management Council (NDRRMC) to "develop risk transfer mechanisms that shall guarantee social and economic protection and increase resiliency in the face of disaster."

[5] RA 9729 was enacted on October 23, 2009, while RA 10121 was signed into law on May 27, 2010.

financial protection initiatives (World Bank n.d.). It emphasizes that the role of DRFI is to "minimize the cost and optimize the timing of meeting post-disaster funding needs" in a manner that "ensure[s] that governments, homeowners, small and medium-sized enterprises, agricultural producers, and the most vulnerable populations can meet post-disaster funding needs as they arrive" (World Bank 2014, 7). Put simply, this means that financing is made available immediately for disaster recovery and as a social protection measure for the poor.

FIGURE 1 Conceptual framework on DRFI

Preference for the poor and vulnerable sectors

Recognizing the differential impacts of climate change and disasters across sectors, RA 9729 emphasizes that preference shall be given to the poor and vulnerable segments of society. The law mandates the State "to incorporate a gender-sensitive, pro-children and pro-poor perspective in all climate change and renewable energy efforts, plans and programs" (Section 2). The World Bank (2017) explains that the financial impacts of disasters impede poverty reduction because calamities destroy not only the resources and livelihood of poor households, forcing them to turn to negative coping strategies such as reducing spending on essential needs or dropping out of school. Within the context of the discussion on the shift to federalism, policy development on intergovernmental fund transfers for disaster risk financing is relevant. This refers to fund transfers coming from the national government to the local government units (LGUs). Arguably, one of the underlying reasons for calls to shift to a federal system is the lack of access to financial resources by local governments who have poor and vulnerable constituents, as government funds are mostly controlled by the national government. Thus, the push for fiscal decentralization with respect to disaster financing has become an imperative policy agenda.

Given this context, the following conceptual framework is used for the study (*see* Figure 1).

To achieve the outcome of having resilient Quezon City communities, financial resilience through risk transfer should be aimed. Hence, a DRFI strategy for Quezon City must be formulated by tilting the balance towards risk transfer by increasing the reliance on external sources of financing—such as local insurance—so that its vulnerable communities may avail of ready funding for disaster recovery. The key question that this study will delve into is: What are the gaps or barriers to implementing risk transfer in local government? The discussion shall center on the experience of Quezon City as an LGU attempting to mainstream risk transfer as a strategy in its Local Disaster Risk Reduction and Management Plan (LDRRMP).

Understanding risk transfer and risk layering

Let us now look at the essential features of risk transfer mechanisms in relation to disaster risk financing and insurance. To do this, we need to look at the concept of risk layering. *Risk layering* is defined as the "process of separating risk into tiers in order to finance and manage risk efficiently" (Mahul and Stutley 2010, xxiv). In this process, the risks for small but recurrent losses are retained by the individual or household, while risks for severe but less frequent losses are transferred to cooperative/mutual insurance schemes, commercial insurers. However, in case of disasters, governments assume responsibility by providing post disaster aid or serve as reinsurers of last resort (ibid.). Simply put, the process of risk layering categorizes disaster risks and matches each "layer" with the appropriate disaster financing solution. Meanwhile, the methods of providing financing solutions through risk transfers are known as risk transfer mechanisms (RTMs), the most common example of which is insurance.

TABLE 1 DRFI policy areas and benefits

Policy area	Benefits	Beneficiary
Sovereign disaster risk financing	• Increases financial response and reconstruction capacity through improvements to: resource mobilization, allocation, and execution; insurance of public assets; social safety net financing. • Clarifies contingent liability arising through disaster exposure of public assets, the private sector and state-owned enterprises, and the poor.	Governments
Property catastrophe risk insurance	• Provides access to compensation for physical property damage and indirect losses arising from damage. • Increases awareness and understanding of financial vulnerability to natural disasters. • Helps distribute risk and burden of recovery between public and private sectors.	Homeowners and SMEs
Disaster-linked social protection	• Mitigates shocks by providing compensation for livelihood or asset losses through flexible social safety nets. • Safeguards vulnerable people from falling into poverty.	The poorest

Source: World Bank 2014, 25

The policy areas for a national DRFI program are shown in Table 1 (above), where we can also interpret these alternatives as the main categories of RTMs. Note here that the beneficiaries may also refer to the elements or sectors exposed to climate and disaster impacts. Following the process of risk layering, they refer to the stakeholders or sectors in need of RTMs.

Based on Table 1, a country's DRFI program should target climate and disaster-vulnerable sectors, mainly the poorest families, homeowners, and small and medium enterprises (SMEs). This is congruent with the policy imperatives articulated in the Climate Change Act of 2009. To reiterate, the important policy considerations here are that RTMs must be immediately made available during the critical period that they are needed—which is right after or as close as possible to the occurrence of the disaster—and must target the most vulnerable sectors.

Review of policy developments

As previously mentioned, major policy developments on risk transfer have only occurred at the national level. The goals and mechanisms of disaster risk financing have been clearly defined in national policy instruments. For instance, the National Disaster Risk Reduction and Management Plan (NDRRMP) includes DRFI under the thematic area Disaster Prevention and Mitigation and tasked the Department of Finance (DOF) to be its lead implementing agency (NDRRMC 2011). Meanwhile, the current Philippine Development Plan (PDP) 2017–2022 crafted by the National Economic and Development Authority (NEDA 2018) has identified risk transfer-related strategies in two of its chapters, namely Chapter 11 (Reducing Vulnerabilities of Individuals and Households) and Chapter 20 (Ensuring Ecological Integrity, Clean and Healthy Environment). The fact that the PDP devoted an entire chapter on individuals and households as target beneficiaries is worth mentioning.

Pursuant to its mandate outlined in the NDRRMP, the DOF developed the Philippine DRFI Strategy. The provisions relevant at the local level are shown in Table 2 (on next page).

Similar to other national policy documents, it is clear from the Philippine DRFI Strategy that RTMs must be accessible to the poor and vulnerable as social protection instruments at the individual and household levels, in addition to property insurance for government assets. The most common RTM is local property insurance. However, as mentioned, policy development on risk transfer has not yet reached implementation at the subnational level.

TABLE 2 The Philippine DRFI Strategy and its relevant provisions at the local level

Development objectives	• Maintain sound fiscal health • Develop sustainable financing mechanisms • Reduce the impact on the poorest and most vulnerable; shield the near-poor
Strategic priorities	• Local level: Provide local governments with funds for post disaster recovery and reconstruction efforts • Individual level: Empower poor and vulnerable households and owners of small and medium-sized enterprises to quickly restore their livelihoods after a disaster
Key initiatives	• Local level: Developing a catastrophe risk insurance facility for local governments; pooling local government's calamity funds; improving insurance of public assets • Individual level: Broadening private property catastrophe risk insurance and micro-insurance coverage; linking disaster risk financing and social protection

Source: Department of Finance n.d.

The Quezon City experience

Quezon City has a large disaster risk reduction (DRR) budget, averaging at Php 854 million for fiscal years 2016 to 2018.[6] Its Local Disaster Risk Reduction and Management Fund (LDRRMF) budget shows that the city's allocation for risk transfer started at Php 500,000 in 2016, was increased twice the following year, and was further increased by 14 times by 2018. While the city's risk transfer expenditures are increasing by leaps and bounds, the allocation for risk transfer, however, is very small—only ranging from 0.09% to 1.03% (as compared to pre-disaster funds or 70% of the LDRRMF), as seen in Table 3 (on next page).

Several observations surfaced upon the conduct of an interview with a key informant from Quezon City's (LDRRMO). These are as follows:

(1) Planning for local property insurance is not part of the functions of the LDRRMO and is undertaken by another department. Therefore, this indicates that there is "no strategic approach yet on how to mainstream risk transfer in the LDRRMP" since there are "no concrete guidelines or a mother framework."

(2) There are no clear guidelines on risk transfer expenditure from the Commission on Audit (COA). Local officials are very conscious of their liability for possible violations of audit guidelines or for failure to provide justifications for such expenditure. They are also very wary that the expenditure will be disallowed, and even of the possibility of having to return the funds spent for risk transfer. Providing social protection through local insurance to the poor may be disallowed because they are private individuals.

(3) COA rules are also very strict because these prohibit the payment of hazard premium for Quezon City's DRR personnel, while allowing to do so for Accredited Community Disaster Volunteers (ACDVs), hence failing to provide protection for them through insurance.

(4) The increased allotment for additional insurance in 2018 for livelihood is a direct result of an innovative technical assistance by a non-governmental organization (NGO).

A deeper examination of the LDRRMP shows the lack of data on vulnerable sectors for the purpose of informing decisions on what RTMs to be selected. While detailed hazard, vulnerability, and risk assessments were conducted for disasters like earthquakes (such as what is dubbed as "The Big One") and flooding due to typhoons, the range of solutions focuses on land use planning, capacity building (e.g., preparedness drills, early warning systems, and DRR trainings), engineering interventions (e.g., flood control programs and purchase of DRR equipment), and even the

[6] The Quezon City Local Disaster Risk Reduction and Management Office (LDRRMO) started its full operations in 2016. Data on risk transfer became available only starting on the same year.

TABLE 3 Quezon City's LDRRMF and risk transfer expenditures

Year	Total LDRRMF	70% LDRRMF	Risk Transfer Expenditure	Percentage of 70%
2016	766,038,834.77	536,227,184.34	500,000	0.09
2017	830,794,187.24	581,555,931.07	1,000,000	0.17
2018	964,970,307.00	675,479,214.90	7,000,000	1.03

Source: Quezon City Local Disaster Risk Reduction and Management Office (LDRRMO)

establishment of a modern disaster operations center, among others. Moreover, while it is laudable that the plan contains numerous risk, vulnerability, and susceptibility maps, socio-economic information on residents is not disaggregated to the barangay level. In fact, the DRR information in the LDRRMP only shows the ranking of Quezon City's most vulnerable barangays, with no data on vulnerability at the household or individual level. In general, geographical or mapping data constitute the bulk of disaster risk information and disaggregated data that are lower than the barangay level are not found in the document.

Gaps on risk transfer at the local level

Based on the results and discussions, there are issues and barriers in implementing RTMs at the level of local governments. The gaps are as follows:

(1) Data from hazard, vulnerability, and risk assessments do not completely inform the selection of risk transfer options as a component of the LDRRMF's investment planning process.

(2) There is no loss and damage framework for exposed elements, especially the vulnerable sectors, to establish the causative link between risk transfer expenditure and assets or sectors that need RTMs as a measure of social protection.

(3) The LDRRMF investment planning process for risk transfer is not synergized with traditional local property insurance expenditure guidelines.

(4) There is a large gap on the implementation of risk transfer due to the absence of clear implementation guidelines at the subnational or local level.

Policy recommendations on risk transfer

Gaps and issues on the lack of a mainstreaming framework and methodology need to be addressed to guide local governments like that of Quezon City as they aim to integrate risk transfer options planning as a means of addressing disaster impacts. The following policy recommendations arise as a result of identifying gaps, issues, and barriers:

(1) Concerned national agencies such as the Department of the Interior and Local Government (DILG), COA, CCC, NDRRMC, and the Department of Budget and Management (DBM) must jointly formulate clear implementation guidelines on the utilization of the LDRRMF for risk transfer mechanisms.

(2) The LDRRMF investment planning process must include risk transfer options planning and be synergized with the local property insurance expenditure planning by designating the LDRRMO as the lead planning department.

(3) The hazard, vulnerability, and risk assessment process—together with a loss and damage framework that allows the targeting of vulnerable sectors at the local level—must inform risk transfer options planning by employing a risk layering approach.

These policy areas must be addressed to guide local governments as they identify applicable financing solutions for their respective risk transfer approaches. As a relatively new policy area, local governments still have to play it by ear, because there are no policies, or even recognized good practices, to guide them in making social protection measures available for their poorest constituents who

become victims of disasters. Further research on the formulation of a framework and methodology on risk transfer options planning in relation to the local DRR planning process will help guide local governments as they strive to become more resilient in times of disaster.

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