

## Addressing Global Risks: Disaster Risk Reduction

Findings from cross-industry session, New York, NY, 27 September 2006

The World Economic Forum, led by its industry partners in Financial Services, convened 150 representatives from 17 different sectors, the US government, the World Bank, and a range of experts from civil society and academia to discuss strategies for reducing the risks posed by natural disasters. The emphasis of the conversation was on multi-stakeholder collaboration: specifically how the sectors represented might partner to support risk reduction activities that no single actor has the incentives or capacities to address independently. Discussion groups tackled proposals for improving insurance, investing in infrastructure, and building economic and community resilience, among others. This document of findings attempts to capture some key thoughts and recommendations from these conversations.

### Opportunities in Infrastructure Industries

A key issue is the potential for 'cascade failure' – a disaster that disrupts a piece of critical infrastructure may trigger cascading disruptions in the global supply chain and economy. Many good models exist for managing these risks, some of which could be applied to infrastructural issues.

**Risk assessment and Standards:** There is a need for a GAAP/IFRS style standard in infrastructural risk assessment and reporting to facilitate investment in mitigation. Mandatory reporting and public transparency for these assessments may end up being a great mitigator. Specifically, there is an urgent need to establish, promote and enforce standards in reinforced concrete construction. Poor standards in rapidly growing urban areas have been a major contributor to increased earthquake fatalities. Extending the WBCSD's Cement Sustainability Initiative to include disaster risk reduction principles could help to reverse this trend.

**Risk transfer:** Cascade failures are not classically insurable, and therefore mandatory catastrophe bonds may be the most appropriate way of spreading infrastructure risk in the financial markets.

**Resilience and Redundancy:** There are many models for mandating spare capacity requirements in the private sector – from the Basel Capital Accords in banking to strategic petroleum reserves in oil markets. Redundancy requirements for large infrastructure providers may be economically onerous; a market that would allow companies to trade their redundancy requirements may generate efficiencies.

**Retrofitting:** Private sector capabilities can be harnessed for retrofitting vulnerable critical infrastructure (both public and private). 'Good samaritan' legislation should be extended to protect corporate partners from liability, while incentives and penalties for maintenance of privatised assets need to be created.

### Finance Industry Opportunities

Financial institutions can do more to reduce disaster risk than provide transfer mechanisms. Credit providers like banks could make it mandatory for businesses to have **catastrophe insurance as a covenant to loans**. Mortgage Providers for householders could also ensure that the homeowners have taken out catastrophe insurance. This mandatory cover could be instituted by the government as a directive to the banks. **Terms and premiums could also be tied to physical mitigation measures.**

Financial institutions could also provide independent (non-government-affiliated) information about risk, akin to the World Bank Hotspots Report. **Credit rating agencies could link their ratings for risks to the Hotspots Report.**

Banks are already taking the lead on creating more financial products, but **innovative synthetic catastrophe derivatives** can help drive demand and increase risk spreading via the capital markets. In the realm of insurance, improved policy to ensure contract certainty and **allow rates that reflect risk** are paramount issues. Until these regulatory concerns and the moral hazards they create can be addressed, insurance will not be able to maximize its risk-reducing potential. However, best practices within the industry also need to be promoted, especially around **tying financial risk to true physical risk**, and using latest-generation loss modelling.