ADB

Completion Report

Project Number: 45433-002
Technical Assistance Number: 8315
June 2017

Philippines: Structuring a Public–Private Earthquake Insurance Pool in the Philippines

Asian Development Bank

TA Number, Country, and Name: TA 8315-PHI: Structuring a Public–Private Earthquake Insurance Pool in the Philippines		Amount Approved: $500,000 Revised Amount: Not Applicable.	
Executing Agency: The Insurance Commission, an agency under the Department of Finance	Source of Funding: ADB's Technical Assistance Special Fund (TASF)-Others	Amount Undisbursed: $119,317.37	Amount Utilized: $380,682.63
TA Approval Date: 20 Dec 2012 TA Signing Date: 24 Jan 2013	Fielding of First Consultant: March 2013	TA Completion Date Original: 31 Aug 2014 Account Closing Date Original: 31 Aug 2014	 Actual: 30 Nov 2015 Actual: 29 Feb 2016

Description: The Philippine Development Plan (PDP) for 2011–2016 translated the Social Contract with the Filipino People into three broad strategies to achieve inclusive growth: (i) attaining high, sustained economic growth through a stable macroeconomic environment; (ii) providing equal access to development opportunities by investing in human capital, and by leveling the playing field through improving access to infrastructure, credit, land, technology, and other productive inputs; and (iii) formulating effective social safety nets including managing climate change adaptation and disaster risks. The Asian Development Bank's (ADB) Country Partnership Strategy (CPS), 2011–2016 supported these objectives and included a specific focus on reducing environmental degradation and vulnerability to climate change and disasters. This project represented a project preparatory technical assistance (PPTA) that was undertaken to provide the due diligence necessary to process a sector development program loan (SDPL) to create a public-private, financially sustainable earthquake insurance entity. The purpose of the proposed SDPL was to: (i) meet market demand and supply earthquake insurance cover on a commercial basis to middle class residential property owners and SME property owners, (ii) legally support the new earthquake insurance entity to underwrite new policies on earthquake risk, and (iii) provide investment capital to assist the entity with solvency rule compliance and volume risk transfer arrangements. The specific purpose of this PPTA was to develop a functional earthquake insurance pool whereby participating insurance companies would cede their portfolios to the pool to be bundled and reinsured internationally.

Expected Impact, Outcome, and Outputs: The expected impact was to enable government and the national insurance companies to proactively manage and transfer earthquake disaster risk. The expected outcome was an agreed project design, a feasibility study, and implementation arrangements suitable for ADB financing under the proposed SDPL. As the SDPL had not yet been fully designed, the expected outputs were deliverables based and included the following:

1) An earthquake pool model, including risk-based premiums presented to and approved by stakeholders,
2) Completed stress testing of the earthquake pool model business plan, investment plan and reserve funds, including the development of operational monitoring mechanisms related to premium collection, claims settlement, and loss assessment, including IT systems to monitor portfolio exposure,
3) A completed governance structure, business and investment plan submitted to and approved by senior stakeholders and,
4) An earthquake pool financial structure ready for investment and demonstrated to investors.

Delivery of Inputs and Conduct of Activities: The PPTA was formulated in close cooperation with the executing and implementing agencies. The PPTA called for a multidisciplinary team comprising international and national consultants. The original plan called for twelve (12) consultants (6 international and 6 national) to be recruited through an international firm, and as individuals in accordance with the ADB's Guidelines on the Use of Consultants (2010, as amended from time to time). The international firm would undertake a demand analysis of the new insurance product, lead the domestic consultants and coordinate with the individual international experts. Individual international financial specialists would be hired on a lump-sum basis to undertake the tasks of (i) team leader, governance and funding structure, (ii) business plan, investment plan, and reserve funding. An individual international insurance and reinsurance expert(s), as well as an international legal expert would be hired on a lump-sum basis to provide specific inputs to the risk modeler and the international consulting team. Catalytics, the open-source platform risk modelling firm, would be engaged on a single source selection and lump-sum contract basis to run the model and provide related capacity building for the project management unit. The terms of reference of the consultants were clear, and the budget was adequate to support all field work, workshops, and staff training. With one exception, the TA was implemented as planned. The initial actuarial consulting firm, AMI Actuaries, was released in June 2013 due to performance issues, and was replaced by NMG Consulting Ltd. (NMG). While all activities were completed on time, the TA completion date was extended by 15 months to November 2015 (original completion was August 2014) to address additional requests from the government. Many of the consultants were not rated due to the departure of the original project officer. The international insurance and reinsurance experts were sated satisfactory. The firm was not rated due to the unanticipated departure of the original project officer. The performance of the government is also considered satisfactory. However, the performance of the ADB is considered less than satisfactory as the basis of the TA was not well assessed and support from the government was limited.

Evaluation of Outputs and Achievement of Outcome: The PPTA did not fully deliver its impact and outcome, and the SDPL was not processed or approved. The government and the national insurance companies can now proactively manage and transfer earthquake disaster risk. However, the business plan and pool were not approved by the government or stakeholders. In general, agreement could not be reached regarding the structure of the pool (e.g. government owned or private sector led), how the premiums would be enforced or whether a government subsidy was required or would be provided. However, the PPTA fully delivered its outputs. A business plan and model for a new direct, mono-line catastrophe insurer was developed. A full analyses of the National Reinsurance Corporation of the Philippines' statistics on earthquake and natural catastrophe statistics was undertaken, together with a full analysis of the exposure of the country's banks to middle class residential lending. In addition, a full spectrum analysis and variable runs were prepared to support actuarial analysis of multiple scenarios. This data was utilized in a review and analysis that applied the newly developed valuation methodology. Knowledge was shared comprehensively. In total, from June 2013–March 2014, the ADB TA team made 43 presentations to external parties and participated in 97 external meetings. However, during the wrap-up meeting held at ADB on 25 July 2014, the Department of Finance and the National Economic and Development Authority requested ADB to continue its activities on the implementation of disaster risk finance in the Philippines but to focus on an analysis of the risk-based premium necessary to facilitate coverage of other more frequent perils, such as floods. This request underpinned the extension of the PPTA noted in section covering the activities of the PPTA. The PPTA's remaining funds of $107,526 were sufficient to cover the additional consulting costs required under the extension period.

Overall Assessment and Rating: The PPTA is less than successful. The TA's focus on supporting the development of an earthquake pool to offset risk for urban residential and commercial beneficiaries was considered relevant. However, the PPTA was considered less than effective. The PPTA accomplished a majority of its outputs and technically provided the government and the national insurance companies an ability to proactively manage and transfer earthquake disaster risk. However, the government and stakeholders did not accept the outputs and did not proceed with the project. Moreover, the proposed SDPL, which was an explicit objective of the PPTA, was not completed. While the PPTA was implemented effectively, the project is likely unsustainable as the government has decided not to proceed with the creation of an earthquake pool.

Major Lessons: The insurance sector of the Philippines is not well developed. The non-life sector is small, and is characterized by a large number of poorly capitalized firms practicing cash flow underwriting. Technical capacity is generally low in both the public and private sector. Recent legislation has been enacted which will begin to address these issues starting with a significant step-up in the minimum capitalization of the non-life sector. In addition, ADB is supporting the introduction of risk-based capital, and capacity development for the insurance regulator as a prelude to a solvency regime. Nevertheless, the development of an earthquake pool presents many complex technical challenges. The PPTA highlighted a number of issues related to political support, cost and sequencing. For example, the condition of the industry makes it unlikely that the project would be profitable lacking some form of subsidy by the government, which is unlikely to be extended to middle-class households. The insurance would need to be force-placed through additional legislation which is a time-consuming process. In addition, the international reinsurers preferred to deal with a government owned and controlled corporation, as opposed to the industry, while the government is attempting to shrink the footprint of these entities. Alternatively, support could have focused first on strengthening the financial condition and technical capacity of the industry. A consolidated, stronger industry may serve as a more acceptable partner to the international reinsurers and could have the pricing power to ensure the premium structure is appropriate. Moreover, under this sequenced approach, government support may not be necessary (see also the Technical Assistance Completion Report for 8037-PHI: Developing a Public-Private Earthquake Pool).

Recommendations and Follow-Up Actions: ADB is currently supporting an effort to develop the government bond market as a pre-curser to, and necessary support for the eventual development of a corporate bond market, and infrastructure bonds. The contractual savings industry, and in particular, life insurance companies will play a key role in the effort. Recent reforms are encouraging. The adoption of the revised insurance code liberalized foreign ownership and paved the way for consolidation through higher minimum capitalization. In addition, the revisions to the insurance code set in motion the introduction of risk-based capital. Re-engagement with the insurance regulator will be necessary to ensure the success of this effort and should be coordinated with the capital market development initiatives of the banking and securities regulators.

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