UNDRR
UN Office for Disaster Risk Reduction

POLICY BRIEF

FINANCING PREVENTION AND DE-RISKING INVESTMENT

OVERVIEW

The COVID-19 pandemic has demonstrated that governments are critically under-prepared to tackle the systemic nature of risk and are underinvesting in and under-prioritizing prevention and resilience. As the reality of climate impacts hit, and if the current approach continues, we will continue to face increased losses.

Total insured losses from natural hazards and human-induced disasters in 2020 was estimated at $187 billion, up by 25 percent from 2019.[1] Indirect socio-economic costs of disasters are many times greater. And we have only a scant understanding of the damage to and losses of ecosystems as a result of disasters.

Yet, in certain countries, domestic public finances earmarked for risk prevention as primary objective are on average less then 1% of national budgets, suggesting a chronic underinvestment in disaster risk reduction.

To add, capital market investments are not yet accounting for disaster risk and are in essence, bankrolling future catastrophes. There is a misperception that disaster risk prevention is the sole responsibility of the public sector and not an issue for the private sector. The true costs of disasters remain external to private sector investment decision-making; and it remains difficult to include these costs and benefits in financial modeling and on balance sheets

Current actions are not commensurate with the sheer scale of the challenge – the rapid accumulation of disaster risk that is systemic, interconnected and cascading. Actions to reverse this trend are needed if governments want to achieve the outcome and goal of the Sendai Framework for Disaster Risk Reduction 2015-2030[2] efficiently and effectively.

KEY POINTS:

- Sustainability and resilience are two sides of the same coin. To ensure investments are sustainable they need to be risk informed.
- To build lasting 'Resilience' – the ability toxcope with shock, to adapt to stress and ultimately to transform through crisis, is critical. But it cannot be done without adequate financing.
- Governments do not prioritize disaster risk reduction because they see it as a cost for an event that might never happen, resulting in devastating impacts when they do occur. Because it is a matter of 'when' and not 'if'.
- For every $100 spent on total development aid between 2010-2018, as little as 47 cents were allocated for disaster risk reduction.
- Global investments of €1.6 trillion in appropriate disaster risk reduction strategies could avoid losses of €6.4 trillion
- It is necessary to promote a 'Think Resilience' approach that becomes mandatory in all in all public, as well as private sector investments.
- In developing sustainable and climate finance, it is important to integrate disaster risk reduction to reorient financial flows and financing in support of disaster risk reduction.

[1] Swiss Re (2020), Swiss Re Institute estimates USD 83 billion global insured catastrophe losses in 2020, the fifth-costliest on record.

[2] See Paragraphs 16 and 17 of the Sendai Framework for Disaster Risk Reduction 2015–2030.

THE CHALLENGES

Between the period 2005 to 2017, $137 billion was provided in development assistance related to disasters, wherein $9.60 out of every $10 was spent on emergency response, reconstruction, relief, and rehabilitation; while less than 4%, $5.2 billion, was invested into disaster prevention, mitigation and preparedness.[3]

Disaster resilience is not prioritized because it is wrongly perceived as politically risky – a cost for an event that might never happen within a political term in most cases driven by lack of visible and well communicated incentives. We are stuck in a vicious circle where the financial cost of disasters is rapidly rising, strapping governments in their ability to mobilize and provide necessary funds, trapped in the vicious and self-fulfilling cycle of disaster-response-recover-repeat. Although there has been substantial progress in upgrading investment into ex-ante risk reduction over the last few years, there is still a serious bias towards reliance on ex-post response, reconstruction and rehabilitation.

Many governments, businesses and financial institutions of all shapes and sizes often do not regularly incorporate considerations related to their exposure and vulnerabilities to the range of hazards identified by the Sendai Framework in their financial decision-making. The data and evidence to incorporate relevant hazard risk analysis into financial decisions may be limited in certain geographies and for certain hazards and can be difficult to access for non-experts.

There is no significant evidence to indicate that investment decisions are considering disaster risks at the transaction level, for instance, £2 trillion in assets under management of UK's pension schemes are exposed to climate-related risks.[4] Notwithstanding the gravity of large-scale and long-term systemic threats, investors (both public and private) may still treat these risks as temporally remote, limited, uncertain, and/or unquantifiable at the level of an individual project or asset, and thus externalize them. The continued reliance on short time horizons as the basis for financial decisions remains a significant contributor to the failure of policymakers, investors, corporations, and project developers to fully consider and respond to disaster risks.

At present, much of the policy, regulation, and accounting practices do not mandate consideration or disclosure of the financial impacts of disasters and even though this trend may be slowly changing, measures are limited primarily to climate risks. If disaster risk is mispriced or underestimated, it can have a financial impact on an institution's income statement or balance sheet, whether it is a company, a credit organization or an institutional investor.

We are seeing the consequences of this unfold in real time.

There is a strong need for a new "social contract" on investing in disaster resilience setting out the responsibilities and liabilities of national governments, financing bodies and the private sector to manage the negative externalities arising from disaster risks.

POLICY OPTIONS

Investing in disaster risk reduction is a precondition for developing sustainably in a rapidly changing climate. It can be achieved and makes good financial sense. Global investments of €1.6 trillion in appropriate disaster risk reduction strategies could avoid losses of €6.4 trillion.[5]

The policy space is at a crossroads. Faced with an increasingly tight fiscal space and existential dilemmas over whether to continue allocating scarce public resources to immediate relief or to invest in disaster risk reduction, including in more inclusive sustainable recovery efforts, political leaders discussing development finance in the era of COVID-19 have recognized the value of investing in ex-ante disaster risk reduction to bridge the short term with the long term, whilst addressing climate change and ensuring overall sustainability. **But this requires a whole mindset shift to take place across the financial system, that is a move from short-term outlook and under-prioritizing disaster risks to promoting a 'Think Resilience[6]' approach that becomes mandatory in all public, as well as private sector investments.**

Political commitment, public buy-in and support is a critical enabler of all of the policy options to move forward this agenda. A basic understanding of and support for a 'Think Resilience' approach will ensure the sustained implementation of the various policy options, so they are not perceived as a temporary trend or linked to a particular party or politician. This requires communications campaigns to better understand disaster risk and the importance of investing in prevention.

The following options can help shift investment decisions and increase financing for risk prevention:

Overhaul regulatory environment and strengthen oversight

Mainstreaming of disaster risk into public and private investment: All decisions, whether they are related to capital investment, social expenditure or environmental protection, have the potential to either reduce or increase risks. National governments and regulators need to define sustainable, disaster resilient investments and encode risk metrics into broader investments to change investor behavior and raise awareness of disaster risks. This will require financial and investment policy and regulatory reforms, guidance to the market and coordination across sectors. Disaster risk metrics need to be considered in the formulation of credit and debt ratings, in indices that measure the attractiveness of sectors and countries for investment, and in performance forecasts for both businesses and countries. Mandatory disclosure of disaster risks should be part of statutory reporting of businesses, financial institutions and governments.

[3] UNDRR (2019), Global Assessment Report on Disaster Risk Reduction.

[4] Financial Times (2021), UK pension schemes face new climate risk reporting rules.

[5] Global Commission on Adaptation (2019), Adapt now: a global call for leadership on climate resilience.

[6] UNDRR (2019), Opportunities to Integrate Disaster Risk Reduction and Climate Resilience into Sustainable Finance.

Ensure financial institutions and banks align their strategies, operations and activities with the Sendai Framework: Central banks and financial supervisors, including auditors, need to integrate sustainability, all potential hazard impacts including related environmental, technological and biological hazards and risks, consistent with the Sendai Framework, into financial stability monitoring and financial supervision. National Governments, through regulation of central banks and supervisor mandates, will need to mainstream disaster risk reduction in the activities of financial institutions and banks by ensuring that their lending decisions support greater disaster resilience. Enhanced guidance to integrating disaster risk into procurement processes, into accounting practices, into international (such as IFRS, IASB) and national accounting standards is equally a critical step.

Creating an enabling environment for effective insurance: Although risk transfer is not a synonym to risk reduction, the insurance market can potentially play an important role in reducing risk, but only where the enabling environment allows for appropriate pricing, coverage and engagement. Not only can the insurance sector decrease the protection gap; if engaged appropriately, through regulatory changes, it could also invest in risk prevention and resilience building, prevent amassing of debt due to disasters and reduce costs of insurance. Mutual and cooperative insurers can equally facilitate risk reduction investments. Moreover, the insurance sector can contribute to understanding the impacts of disasters in various sectors through disaster risk assessment as a precondition for premium setting.

Build the evidence base

Track prevention financing: Tracking financing flows in risk prevention as well as other fiscal data would support in identifying the volume of investment utilized out of the budgeted allocation and more importantly how much of it reaches the intended goal or beneficiary action. Observatories at national, regional or global level could help quantify and track investments which, supported by cost benefit analysis, will allow public and private sector to measure the real outcomes of investments in disaster risk reduction. Such observatories could build on existing methodologies and further improve it by labelling prevention investments.

Conduct risk-sensitive budget reviews: For holistic and financially sustainable management of disaster risk, a portfolio of risk reduction investments needs to be developed that considers all the phases of the risk management cycle. National DRR- sensitive budget reviews can demonstrate the direct and indirect proportion of DRR allocation and expenditures, in each specific sector. Combined with robust risk assessments these reviews could provide evidence on potential losses emanating from various hazards and identify various sectors in the short and long term that require increased investment. To ensure that budget reviews do not remain only an ad hoc one-time exercise, specific tagging and tracking systems need to be developed and institutionalized.

For additional information, please visit:
undrr.org
preventionweb.net

Increase use and application of risk and financial data: While there have been many efforts to collect and provide open access to hazard risk, exposure and vulnerability data, and data on losses caused by disasters associated with natural and human-induced hazards, its use and interconnection with financial decision-making could be significantly expanded. This is especially the case for ensuring that the financial rationale for risk reduction, e.g. comprehensive evidence on either the financial, economic, societal and environmental costs of hazards, or the value of taking preventative actions, is in a format which is usable by the investment sector. It would be critical to explore the application of global earth observation (EO) data, big data and Artificial Intelligence (AI). Cost benefit analysis based on risk information would equally assist identifying how much risk could be prevented or reduced and could be part of integrated national financing frameworks.

New and innovative financing models

Promote blended financing and introduce prevention in bonds: Not all resilience projects can be funded by public resources, which are often constrained by limited budgets and competing priorities. Moreover, public sector institutions are not the only ones to gain from an increase in resilience, and it should be possible for risk prevention projects to draw on all potential beneficiaries for funding. Innovative financing models such as blended finance and impact investing have emerged as one of the tools for addressing risks and encouraging the private investments that can transform people's lives and contribute toward the Sendai Framework implementation. Another opportunity is to introduce prevention as a key criterion in climate-resilience bonds, green bonds, social and sustainability linked bonds that would help in leveraging finance for prevention, adaptation and mitigation actions.

Establish a pipeline for disaster and climate resilient infrastructure investment: Infrastructure is an essential component of financing for disaster risk reduction. Investment required in infrastructure and addressing the resilience of these assets is immense, at the same time Infrastructure can be a profitable category for investors. To meet the infrastructure demand and fill the financing gap, public private partnerships remain a good practice that needs to be strengthened. Infrastructure investments are well suited to the portfolios of institutional investors. Co-benefits, bankability and pipelines of infrastructure projects supported by strong commitment of national governments and regulators will drive markets' interest and foster stronger partnership between public and private sector.

COVID19 Stimulus package to build resilience: Governments worldwide are now spending vast sums of money on the economic recovery which will significantly influence our ability to deliver a green, resilient recovery. Covid-19 and complex disasters have highlighted the need for more investment in ex-ante resilience and the economic stimulus packages are an opportunity to address multiple risks, including climate change impacts. Consequently, there is a need to enhance a systems and resilience-focused approach to COVID-19 stimulus and recovery plans that gives due attention for preventing the next shock. This requires recognizing the importance of ex ante action and implementing a 'prevent first' and 'do no harm' policy.