Belt and Road countries and insurance-linked securities

Phoenix CRetro Reinsurance Company chief executive **Kirill Savrassov** says as huge investments are being poured into the Belt and Road Initiative across Asia and Europe, the introduction of catastrophe bonds can take the risk off government balance sheets and reinforce macro-economic stability while providing access to rapid recovery funding.

The day I was writing this article, an earthquake measuring 5.8 magnitude shook Istanbul, causing panic amongst residents, evacuation of schools and public offices. It also led to the collapse of the minaret of a mosque in Turkey's most populous city.

The Turkish 'quake happened during the same week in which another 5.8 magnitude 'quake event in north-eastern Pakistan killed 38 people and injured more than 700. It also caused extensive damage to infrastructure and roads in that region of Pakistan.

In 1999 an earthquake of 7.4 magnitude in the western part of Turkey killed more than 17,000 people. Besides threatening Istanbul itself, the latest tremble acts a strong reminder that Turkey, as part of Eurasia, always had a threat of various natural disasters and earthquakes.

Almaty (1911), Ashgabat (1948), Tashkent (1966), Spitak (1988), quakes almost totally ruined the respective cities and the 2014-2016 Balkans floods which caused tremendous damage to the economies of the affected countries are some of the major disasters that have ravaged the region in the past.

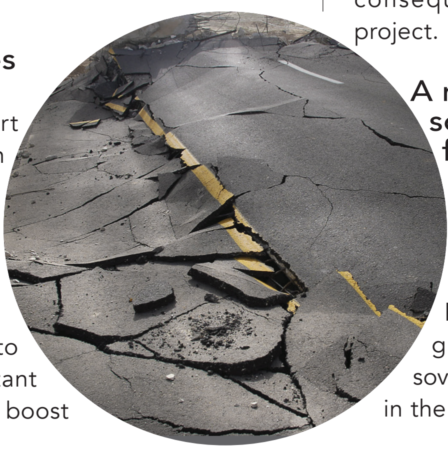
Europe and Commonwealth of Independent States (ECIS) are a highly prone region to a wide range of natural disasters.

Turkey was always positioned as the bridge between Europe and Asia and now, with the new Silk Road project, this title covers the entire region between mainland China and the European Union.

Natural disasters, especially earthquakes can upset the BRI

With the Belt and Road Initiative (BRI) and transport corridors passing through countries of CIS and western Balkans the threat of devastating natural disasters and earthquakes in particular take on new dimensions. Especially if the corridors and new infrastructure creation pass through the most earthquake-exposed territories of Eurasia if not the world.

With investments of billions of dollars going into critical infrastructure, the BRI is seen as an important opportunity to expand international trade and give a boost to regional economies.



The issue of protection in case of large disaster, however, remains open and burdened by some regional specifics. With an underdeveloped insurance market where penetration is less then 2% and state ownership (and hence responsibility) of critical infrastructure is the norm, insurance does not play any meaningful role in case of a really devastating event. The post-disaster finance arrangements can raise a big question mark in such cases.

This also relates to the potential of contingent business interruption losses whereby an earthquake in say Kazakhstan or Uzbekistan may stop the whole corridor to operate for significant amount of time with consequences for the whole BRI project.

A niche risk-transfer solution is required for the Eurasian BRI nations

If there is to be a solution that benefits everyone, it is likely that the solution will have to be organised by the governments, whether on a sovereign or sub-sovereign levels in the form of disaster risk transfer and ideally combine all the best practices having developed over time in other parts of the world.

Over the last two decades, financial markets, governments, and the development community have introduced important innovations in disaster-risk finance, giving rise to a collection of funding sources after disasters strike. These include national regional pooling schemes, contingent credit lines, parametric disaster-risk insurance, catastrophe bonds and other insurance-linked securities.

Transfer of peak risks to capital markets would be the most viable option

With geo-strategical fragmentation, however, creation of a regional scheme like CCRIF or ARC becomes difficult. Also, low sovereign credit ratings make it difficult to increase the burden onto the budget in case of credit arrangements. Hence, the transfer of peak risks to capital markets in the form of parametric sovereign catastrophe bonds seems to be the most viable option in this particular region.

Successful examples of Latin America, Caribbean states and Africa where such bonds have probably proved the concept, having received investors' appreciation for simple, transparent and well-defined trigger mechanism and even several pay-outs over the years.

A government of the ECIS region's country considering such type of disaster-risk transfer will ensure certainty around budgetary planning, fast capital deployment after the event if triggered by pre-defined parameters, no obligation to repay such funds as traditional disaster relief, reduction of contingent liabilities with protection of sovereign rating and currency and obviously less need to move capital from other projects to disaster relief and rehabilitation exercise.

Also with the involvement of China as investors, in such bonds, they will obtain a stable protection of invested money, organised by transit countries avoiding the need of complicated and not always available insurance solutions.

One important aspect is that issuance of sovereign CAT bonds is not rocket science. If a country has ever considered or issued Eurobonds, it is all set and ready to do the same in case of catastrophe bonds in terms of legal readiness.

Singapore's foray into ILS sphere can be a booster

Two other important factors in favour of potential ECIS sovereign CAT bonds are intra-class diversification and Singapore's recent endeavours in the ILS the sphere thus boost the concept for Asia.

The stable appetite for ILS an uncorrelated asset class that institutional investors experience is presently concentrated on North American exposures. There is, therefore, a potential for intra-class diversification and any new territory, especially the one yet to be explored, shall attract big interest.

These would obviously be subject to transparent and compliant structuring, which ECIS countries can now enjoy based on the lessons learned in other parts of the world over the last decade. Singapore's success in becoming an ILS centre in Asia has been proved by the issuances of IAG, Security First and Safepoint's bonds this year and it clearly shows both availability and interest for diversification in terms of ILS centres.

Some of these bonds cover perils outside Asia and are combined with a unique and one of its kind grants scheme from the Singapore government.

ILS can also improve disaster resilience in the region

Investments into ECIS regional CAT bonds can also become a good instrument for the development banks in their desire to support the developing nations and improve disaster resilience in the region.

In addition, use of such a form of disaster risk transfer as catastrophe bonds solves a fundamental problem of addressing the 'protection gap'.

It is for this reason that international development partners like United Nations Development Programme and Asia Development Bank are working with the countries of the region and introducing various post-disaster risk finance options including ILS solutions.