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DISASTER INSURANCE AND SECURITY RESERVE PROGRAM

A PROSPECTUS

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DISASTERS INSURANCE AND SECURITY RESERVE: A PROSPECTUS

I. This prospectus outlines a disasters insurance scheme to provide insurance for people most likely to suffer loss in the event of a natural disaster in selected developing countries (LDC's). The program is designed to serve low income families and small businesses who are unable to secure traditional insurance coverages and to provide a low-risk investment for policy holders. The program initially will operate in the LDC's which are vulnerable to earthquakes, cyclonic storms, volcanic eruptions and/or widespread floods.

The insurance company will be run by a central corporation which will serve as coordinator of the program, supervisor of subsidiaries and investor of the policy holders' funds.

II. Background

Established insurance companies have found it uneconomical to provide coverage for low income families and small businesses in the LDC's using the established insurance methods. The majority of people in these areas live and work in non-engineered buildings made of materials for which it is difficult to ascertain susceptibility to damage in a disaster and establish a replacement value. Furthermore, the costs of policy marketing, policy administration, and claims adjustment would appear to make the premiums prohibitive for the market. The DISR program provides an approach by which these constraints may be overcome.

III. The Roles of Disaster Insurance

When a disaster strikes in the developing countries, one of the most critical needs of families and small businesses is cash for reconstruction. Because no insurance schemes are available, the burden has traditionally fallen on international relief agencies and the host government to provide the capital necessary for reconstruction. The problem is that this money is usually earmarked for designated programs. In most cases, the disaster victim has no direct access to the funds, as decisions are made by the relief agencies and work is done on their behalf. For example, relief agencies may offer loans to the homeowner, but decisions on how the money will be spent, which contractors the money will be paid to, and the amount that each family is eligible to borrow are all decisions made by the lender rather than the family. An appropriate insurance program could provide a much needed source of unencumbered funds, i.e. those which the victim has control over and can use as he wishes.

To understand the importance of insurance, it is necessary to understand the role it can play in a disaster. Insurance can eliminate or reduce the possibility of complete financial ruin, should a disaster strike. It can provide a means of access to funding which would otherwise not be available. It is doubtful that after a disaster, for example, poor people would be able to borrow substantial sums in order to rebuild. Insurance is a potentially cheap way to make sure that they have access to these funds.

A second aspect is the effect that a rapid settlement of claims can have on a community. Researchers have noted that if settlements are quick and substantial, it can have a major impact on lessening the emergency period and beginning a transition into rehabilitation and reconstruction. This injection of capital, even on a small scale, not only has a psychological benefit, but can stimulate rehiring and the restart of markets. As a rule of thumb, the larger the proceeds and/or the greater the percentage of people covered by insurance, the quicker recovery will begin and the shorter the recovery period will last.

The third aspect is the role that insurance plays in reducing the burden on financial institutions in the affected community. If businesses and industries are not insured, the money for their reconstruction will have to be provided through the conventional financial institutions within the country. This reduces the capital available for reconstruction of small businesses and to families and individuals. Insurance for this sector could help fill this gap and, if coverage was widespread, potentially increase the money available in each sector.

IV. Background to the Market

The DISR program is aimed at two groups in the developing countries. These are designated as the primary and secondary markets.

A. Primary Market

The primary market is composed of individuals that either own a house or land, or have long-term tenure arrangements for the building or land that they occupy, and who are members of a co-op, trade union, guild, collective farm, or who are members of some other similar, formal affiliated group. In most countries, these people will make up approximately 15% of the total population of the selected country. Economically, these people would be classified as lower middle class or upper level low income families.

Marketing to the primary group will be through their affiliated organization.

B. Secondary Market

The secondary market is the same economic group, but are those who are unaffiliated with a group. In addition to families, small businesses will be included in the secondary market group. The secondary market will account for an average of 15% to 20% of the total population of the selected country.

Marketing to the secondary group will be through advertising media and in selected communities through advertising media and in selected communities through direct mail.

The characteristics of both the primary and secondary markets are:

A. They are people who have aspirations for a better living standard and who are, to some extent, upwardly mobile.

B. They have small, but steady incomes.

C. They are functionally literate and are exposed to a variety of media (radio, television and/or newspapers).

V. The NaDIP Program and How it Works

A. Policy and Terms

It is recognized that because of the characteristics of the market and, because these people have not participated in insurance programs to date, the full statistics upon which actuarial data can be derived are not currently available. Thus, the NaDIP Plan must remain flexible and subject to change to meet economic considerations. It is felt that the initial plan offers a policy and terms that can meet the needs of both the policy holder and the company in this market. Variations will, however, be made when necessary.

Initially, the basic policy will work thus: The company will determine the cost of an average, non-engineered house and the value of a "typical" small business. To each value, a factor will be added to allow for inflation in a post-disaster environment. These figures will be used to determine the minimum cost and value of a policy. The company will then set an annual premium rate as a percentage of that cost. The policy holder would be permitted to purchase insurance in increments based on the minimum cost of the policy. The policy holder may buy as many increments as he wishes, but not less than the minimum value. The policy is written on the address that the policy holder states for the value that the policy holder declares he is willing to pay. There will be no inspection of the home or the business. Each policy is simply a policy for a certain face value. The schedule of payments will be established taking into account the regional economic variations in the economy and cash flows. For example, farmers may pay their premiums semi-annually, according to the harvest seasons for cash crops.

As an example, assume that the average cost of a non-engineered structure in a certain country is approximately $200. In a post-disaster environment, the replacement cost of the building may rise by as much as 50%. Thus, the company would establish an insured value of $300 as the minimum policy. The annual premium would be set as a percentage of $300. In our example, assume that the percentage set is 10% of the value, thus, the annual premium would be $30 per year. If the home or business owner wishes to purchase another increment of insurance, he may buy $400 worth of insurance for $40 per year, $500 for $50 per year, or $600 for $60 per year.

If a disaster were to occur, proceeds would be paid according to the following steps: First, the company would determine the boundaries of the affected area. (For each type of natural disaster, this can be done scientifically.) All insured addresses in the affected area will be paid the face value of the policy without question. Policy holders outside the zone who can establish that their homes or businesses were damaged by the disaster phenomena will also be paid the face value of the policy. Payments will be made without regard to whether or not the address affected has been damaged or destroyed.

It is recognized that the benefits that insurance can provide in a disaster are in themselves insufficient incentives to low income people to purchase a policy even on very favorable terms. Thus, to make the policy both attractive and justifiable to the people in our market, other incentives must be incorporated into the policy. The ~~NaDIP~~ DISR plans will thus offer a variety of both pre-and post disaster benefits which will both improve marketability and enhance acceptability of the scheme to the governments of the host countries. The package for each country will be tailored to that market but a combination of any or all the following may be offered as incentives.

B. <u>Disaster-Related Incentives</u>

1. As an incentive to reducing vulnerability, people who are building disaster-resistant houses can receive insurance at a discount.

2. The proceeds paid will be equivalent to the amount paid in U.S. dollars at the time of the annual payment.

3. To assist in reconstruction, the company will provide information on disaster resistant construction techniques, and where possible, technical assistance to people in the building trades in the effected area so that disaster-resistant construction can be facilitated.

4. As an incentive for building safer construction, homeowners who agree to rebuild their houses using disaster-resistant construction techniques will receive a bonus ~~of 5%~~.

5. As an incentive for participation, payments would end when a predetermined percentage of the face value of the policy is paid.

C. <u>Non-Disaster Incentives</u>

In addition to the proceeds paid if a disaster were to occur, the company will attempt to establish non-disaster-related benefits for policy holders. They are:

1. The policy would have a predetermined cash surrender value which would allow the policy holder to borrow against the policy or surrender it for cash after a specified period of time has elapsed.

2. If feasible, a portion of the money paid out of any one community will be reinvested in the community or activities which will benefit the policy holders.

3. For organizations that participate in the program, a portion of the money will be reinvested in that organization, or alternatively funds may be made available in the form of loans to the organization for financing activities which could benefit the policy holders.

4. Cash reserve Similar to a traditional whole life contract. The policy would have a pre-determined cash surrender value.

VI. Entry Strategy

The entry strategy for the primary market is through their affiliated organizations. Each organization will be approached to serve as the insurance agent for its members. For this, there will be three benefits for the organization.

A. For serving as the agent, the organization will be paid a commission on each policy. If a certain percentage or more of the members participate in the insurance scheme each year, the organization will receive a cash bonus.

B. If a certain percentage of the members of the organizations participate in the program, the organization will become eligible for applying for loans.

C. In certain cases, funds derived from policy holders may be reinvested in the organization or activities which directly benefit the organization and its members.

The entry strategy for the secondary market is by general advertising. Advertisements will be placed in those media which have proven access to the secondary group. Advertising will direct people to an agency or agent who can prepare the policies.

In certain countries, a direct mail approach may be feasible. This will be determined on a case by case basis and, if feasible, such activities will be undertaken.

VII. Risk Dispersal

During the initial years, the number of policies in any one area or community will be limited so that marketing can commence in a number of areas at the same time. This will serve to spread the risk until a large and balanced number of policy holders exist. Specifically, risk will be spread:

A. Between communities in any one country.

B. Between countries in a region.

C. Between communities and countries by disaster type.

VIII. Investors Concerns

In any venture in the developing countries, a number of factors will be of concern to investors. These include legal implications of a trans-national corporation, legal aspects of transferring capital between countries and concerns over possible nationalization. These factors are also of concern to the company and the following approaches to each of these problems have been considered.

A. Establishing National Offices

In each country, a legal company will be chartered as a subsidiary of the primary company. Because the insurance pool scheme does not fit precisely into the normal insurance categories nor do the rein-vestment aspects of the incentive program follow the traditional lines of investment, it is felt that in some countries, special enabling legislation may be required. Because the program, however, can be seen to be anti-inflationary and as taking a major burden off the government, it is believed that there will be little difficulty in establishing the subsidiary companies.

In those countries which will not permit a subsidiary arrangement, the prime corporation will serve as a reinsurer and provide technical assistance to an existing insurance company to establish a program under the specifications of the NaDIP framework. For reinsuring the local companies, a direct fee will be charged.

Because the program is complimentary to many of the established development goals of the LDC's and because the scheme will be working through many institutions which are supported and encouraged by the local governments, it is anticipated that a great deal of flexibility will be permitted the company in its operations.

B. Transfer of Capital Between Countries

Certain countries have tight restrictions on the transfer of funds to foreign accounts. Initially, the program will avoid these countries. If such legislation were passed for a country where a NaDIP Program were already established, alternative means of transferring funds would be sought. This can often be accomplished by purchasing and exporting raw materials or commodities, by purchasing locally produced goods for which foreign markets exist, or by transferring money to an intermediary country where such transfers are not restricted.

It is not foreseen that the transfer of funds will be a major difficulty and, that were such legislation to be passed, an exemption would be permissible due to the benefit that the country would receive from the insurance scheme and the associated incentives.

C. Nationalization

Possible moves to nationalize the insurance scheme are considered highly unlikely. Insuring low-income families and small businesses will take a tremendous financial burden off the host government in the event of a disaster. The concept of reinvesting portions of the fund and making loans and grants available to individuals and organizations, plus the non-inflationary aspects of the program, all contribute to make any proposed nationalization move self-defeating.

On the remote chance that nationalization would be proposed by a radical regime, protection would be established through sources such as the Overseas Private Investment Corporation (OPIC) an office of the U.S. Government that insures some overseas risk, and other appropriate organizations. In addition, other legal and financial mechanisms would be developed to provide protection for investors.

D. Investments

Investments of the corporation will be under the supervision of an Investment Advisory Board appointed by the Board of Directors of the company. It will be the policy of the company to actively seek and develop investment opportunities which will benefit the developing countries. A parallel institution may be established to coordinate investment activities in the developing countries, and make portions of the funds available for loans to individuals and organizations. The form which this institution will take will be established by the Board of Directors. Investments will only be made in those countries which will allow profits to be transferred to foreign accounts. (This is to protect both investors and policy holders.)

For further information about the proposed Disaster Insurance and Security Reserve Program, contact:

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INITIAL CAPITALIZATION PLAN

I. <u>Program Coordinator</u>

The Texas Insurance Development Corporation (TIDC) has been established in the state of Texas to coordinate and implement this program. The responsibilities of TIDC include:

A. Providing the conceptual framework;

B. Bringing together the insurance expertise necessary to set up an offshore company to manage and provide the prime insurance for this program;

C. Contracting with INTERTECT to provide the technical resources to:

   1. Evaluate natural disaster phenomena as a viable insurance risk;

   2. Define market parameters for coverage; and

   3. Assist in securing the cooperation of interested parties in the participating countries.

D. Attracting the initial investment required for carrying out such a venture.

For its services, TIDC will retain no less than 20% ownership in the company and receive 10% of the gross premium collected.

Once initial coverage is in place, TIDC will continue to participate actively with the offshore insurer to expand its activity and, by subcontract with INTERTECT, to provide the resources necessary for damage assessment.

II. The Offshore Insurance Company

In order to implement this scheme, an offshore insurance company will be established in the Cayman Islands to:

A. Directly write the necessary coverage;

B. Contract with existing local insurers to write the coverage; and/or

C. Establish subsidiary insurers as may be needed to write the coverage.

Initial coverages offered will be in minimum units of $300 to a maximum of $1,500 at risk. Gross premium is anticipated to be $37.87 per year for each $300 at risk with a premium-paying period of ten (10) years. Sixty percent ($22.72 per unit) of that premium represents pure premium which, at 5%, will endow for the face amount at the end of the ten-year premium-paying period. At the sixth year of the period, a loan reserve will be established for each policyholder and be made available to those qualifying at a pre-determined guaranteed rate of interest (initially 12%).

It is hoped that a participating contract will be developed and dividends paid to policyholders, assuming favorable claims experience.

III. Initial Investment Capital

To establish the offshore company, a minimum of one million dollars investment capital will be raised. Assuming a $3 risk to $1 reserve ratio, this will allow the company to write three million dollars of risk in the initial phase of the program.

It is proposed that additional reserves be raised in each of the first five years of operation. This will be raised by issuing a series of five-year five percent (5%) debentures at the beginning of each year in an amount not to exceed $4 for every $1 of anticipated new premium. New premium will be based on the amount of risk that can be absorbed by existing reserves less debenture liabilities at the beginning of each year, assuming the $3 risk to $1 reserve ratio. Five percent (5%) interest will be paid annually with principal due at the beginning of the sixth year.

It is anticipated that approximately one million dollars of these debentures will be issued at the beginning of the first year.

IV. <u>Participation Capitalization</u>

Where coverage is provided through a contractual arrangement with a local insurer, the following provisions will apply:

A. The local insurer will write and issue the contract subject to contract specifications of the offshore company.

B. All premiums will be collected by the local insurer.

C. The local insurer will forward all pure premiums to the offshore company.

D. The local insurer will pay to TIDC as a service fee 10% of gross premiums.

E. In addition, the local insurer will contribute 10% of gross premiums to a trust fund established in the Cayman Islands in return for equity in the offshore company not to exceed 5%.

F. While the offshore company will assume or reinsure all of the risk insured to its specifications, the local insurer will be responsible for the actual distribution of claim settlements as well as policyholder loan administration.

G. Apart from those marketing services provided by TIDC, the local insurer will be responsible for marketing, commissions and other local administrative activities as may be necessary to efficiently implement the scheme.

H. Subject to satisfactory performance relative to offshore company's specifications, the local insurer will retain an exclusive contract.

SUMMARY

PREMIUM SHARE	UNIT	RESPONSIBILITY
60%	Offshore	(1) Assume all insurers risk (2) Provide loan reserves for policyholders (3) Provide contract specifications (4) Assume cost of damage assessment
10%	TIDC	(1) Provide technical services as to viability of risk (2) Provide market parameters for coverage and other related marketing services (3) On a cost basis, provide damage assessment capability
30% *	Local	(1) Assume responsibility for policy issue and distribution (2) Assume responsibility for claim settlement and loan administration (3) Assume primary marketing responsibilities in conjunction with TIDC

* Initially 10% would be contributed to equity in offshore company, not to exceed 5%.