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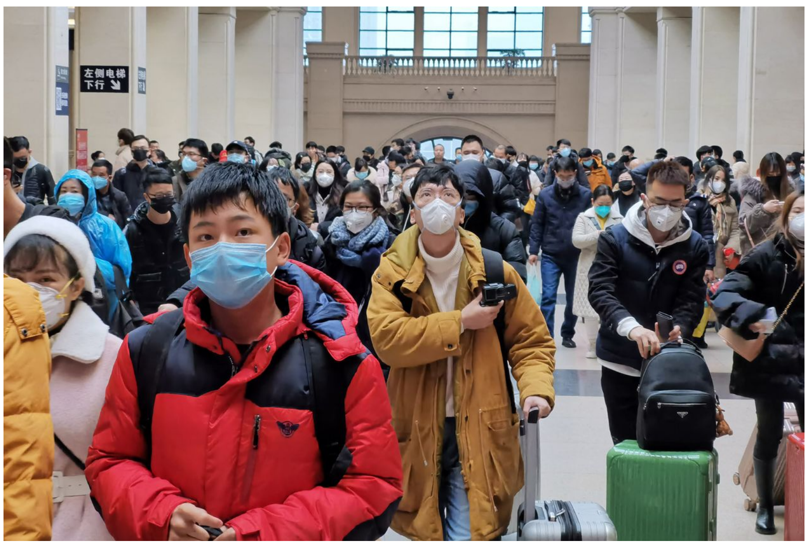
MARKETS

Coronavirus Outbreak Tests World Bank's Pandemic Insurance

If the pandemic-catastrophe bonds are triggered, critics say any eventual payments could be too little, too late



During a pandemic, affected countries need money to respond to an infectious disease while it is still spreading. People wait at Hankou Railway Station in Wuhan, China, last month.

PHOTO: GETTY IMAGES

By Nicole Friedman

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It's the third month of the coronavirus outbreak, and investors still don't know whether the first-ever pandemic-insurance policy will pay out.

The World Bank issued pandemic-catastrophe bonds in 2017, a novel test of the ability to insure against global epidemics. The issuance marked an effort to expand the use of catastrophe bonds—financial instruments that were designed to help investors bet against natural disasters like hurricanes—to a new category of global risks.

Large investors such as pension funds and endowments have piled into catastrophe bonds in recent years as they seek diversification and higher returns. They work like this: Bondholders collect attractive interest payments on the bonds, but if certain events occur, like hurricane winds above a certain speed, investors can lose some or all of their principal.

Designing a pandemic bond was a new challenge. For bonds that are triggered by natural catastrophes, the principal can be used to cover damage after a disaster has occurred. But during a pandemic, affected countries need money to respond to an infectious disease while it is still spreading.

If the pandemic bonds are triggered, some or all of the investors' principal would go to the World Bank to distribute among developing countries affected by a disease outbreak. The interest on the bonds is paid by two donor countries, Germany and Japan.

In the years since they were issued, the pandemic-catastrophe bonds have never been triggered. Critics say any eventual payments could be too little, too late.

Chin Liu, portfolio manager at Amundi Pioneer in Boston, said his firm bought the pandemic bonds to diversify its $1 billion catastrophe-bond portfolio.

"As an investor we do not want to lose money," he said. "But then we also understand, if it's unfortunately triggered, it benefits every single person including ourselves to keep the virus controlled."

The total value of the World Bank's pandemic bonds outstanding is $320 million. For a coronavirus event, the maximum potential payout is $195.83 million.

The pandemic bonds can be triggered by a combination of factors. First, at least 12 weeks need to have passed since the start of a nonflu outbreak. The World Bank said the 12-week threshold was met earlier this month.

"The whole scheme is set up to minimize the probability of payout," said Olga Jonas, senior fellow at the Harvard Global Health Institute, a former economic adviser at the World Bank and a prominent critic of pandemic bonds.

Twelve weeks is too long to wait to disburse payments, she said: "The instrument has triggers that are well into an epidemic that's about to be out of control or already out of control."

For the Class B pandemic-catastrophe bonds, a partial payout could be triggered by at least 250 coronavirus-related deaths in one country and 20 in a second country. One of those locations needs to be a developing country. The outbreak must also be spreading at a certain rate.

So far, coronavirus has led to 1,870 deaths in China and three deaths outside of China, according to the World Health Organization. China wouldn't qualify to receive payments if the bonds paid out.

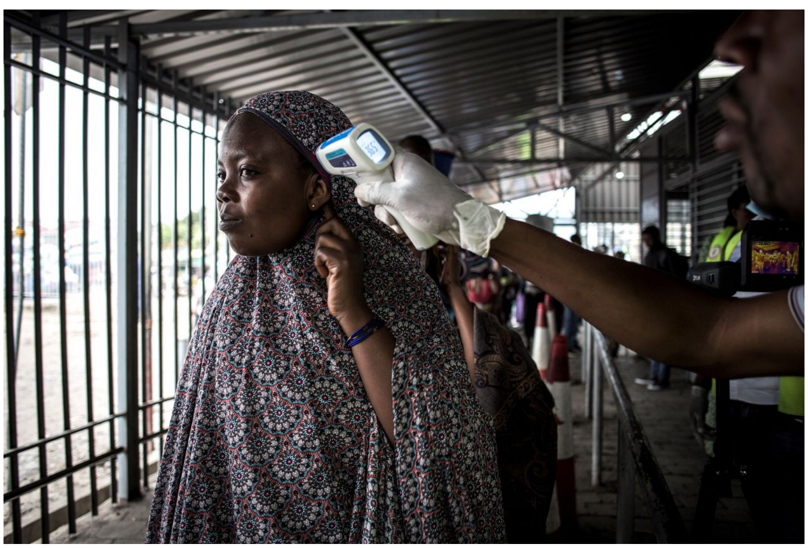
Catastrophe-bond brokers said they were willing to buy the Class B bonds at an average of 63.75 cents on the dollar as of Jan. 31, according to consulting firm Lane Financial LLC. The bonds have historically been lightly traded, and quoted prices don't indicate that trades have occurred.

"The longer it takes and the more the outbreak is not contained, it of course increases the likelihood that we could see a trigger event from the coronavirus," said Dirk Schmelzer, partner at Plenum Investments AG in Zurich, which manages $410 million in catastrophe bonds and owns the lower-risk Class A pandemic bonds.

The Class A bonds could be triggered if the coronavirus leads to at least 2,500 deaths in one country and 20 deaths in a second country. But the bond is primarily intended to respond to a flu pandemic, and the maximum amount of the principal that could be lost for a coronavirus event is 16.67%.

The Class A bonds pay investors 6.5 percentage points above a key benchmark rate, while Class B bonds pay 11.1 points above the benchmark. The bonds are set to mature in July, at which point the investors can get their initial money back if the bonds haven't been triggered.

The catastrophe bonds are the biggest component of the World Bank's Pandemic Emergency Financing Facility. The facility also includes $105 million in pandemic swaps and a cash component. The cash can be spent at any time and on outbreaks that aren't covered by the pandemic bonds and swaps.



A woman gets her temperature taken at an Ebola screening station as she enters the Democratic Republic of the Congo from Rwanda in July 2019.

PHOTO: JOHN WESSELS/AGENCE FRANCE-PRESSE/GETTY IMAGES

The World Bank said the facility is intended to fill the gaps after an outbreak has occurred but before large-scale humanitarian aid has arrived.

Criticism of the pandemic bonds increased last year, when an Ebola outbreak in the Democratic Republic of Congo failed to trigger bond payments. Ebola caused more than 2,000 deaths in Congo, but the outbreak didn't meet the threshold of causing at least 20 deaths in a second country.

"A number of journalists and bosses of mine have said, you made a huge mistake" because the bonds didn't pay out, Michael Bennett, head of derivatives and structured finance at the World Bank, said at the Trading Risk conference in New York in October.

But covering a single-country outbreak would have required higher interest payments to investors than do the current bonds, which insure against multi-country outbreaks, he said.

"There should be a certain allowance for first-time transactions," he said. "We're learning from it."

Even though the bonds weren't triggered, the World Bank's pandemic cash facility paid out $61.4 million in 2018 and 2019 to help contain Ebola.

If the pandemic bonds are not triggered by coronavirus, "it could be déjà vu all over again," said Morton Lane, president of Lane Financial.

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Are pandemic catastrophe bonds an effective tool for the World Bank? Why or why not? Join the conversation below.

Corrections & Amplifications

Michael Bennett, World Bank head of derivatives and structured finance, said in October, "A number of journalists and bosses of mine have said, you made a huge mistake," after the bank's pandemic bonds didn't pay out following an Ebola outbreak last year. An earlier version of this article incorrectly quoted him as saying "a number of governments and bosses of mine." (Feb. 20, 2020)