



FACTSHEET

Climate Risk Insurance: Developing a Strategic Concept for Implementation

1. Approaching climate risks comprehensively

In the realm of policy, practice, and academia, the term “insurance” is used in different contexts and it is important to be aware of the various ways of thinking about insurance. By making the distinction between broad concepts of risk management to improve assurance and more specific tools including insurance helps countries, communities, and people match the kind of risk they need to manage with the set of appropriate approaches.

- **Risk management to assure** that risks do not overwhelm the ability to pursue life cycle or social objectives. For individuals, that may mean taking measures to assure that objectives like improving household welfare, obtaining an education, maintaining health, and/or keeping a job are not impaired by the risks they face in their daily lives. These risk management measures might mean diversifying the kinds of crops they grow or species of animals in their herds, investing in social or other networks that can lend a helping hand in times of need, or building different skill sets in case one choice of job doesn't work out (e.g., a construction worker could learn tailoring in case he/she loses a limb or gets injured to secure an alternative way of income generation). For governments, seeking assurance vis-à-vis climate risks may mean investing in social safety nets, national disaster management programs

or other measures to make sure that big policy objectives like poverty reduction are not impaired if adverse events happen.

- **Insurance as a tool to transfer financial risk** can help managing the financial implications of a certain shock. A variety of insurance products exist to deal with specific kinds of climate risks. For individuals or households this can include crop insurance or homeowner's insurance against flooding. For communities or governments, insurance products could protect infrastructure or the agricultural sector in case of adverse weather events like hurricanes or cyclones. The characteristics of insurance tools include:
 - a) Identifying and pricing the risk.
 - b) Entering a formal agreement between two or more actors to transfer the financial risk under specific circumstances.
 - c) Payment of a premium by the insured party in exchange for the promise of a payout by the insurer if the insured risk materializes.

2. What actors are involved in providing climate risk management solutions?

A range of different actors are involved in finding appropriate climate risk management solutions. This is important to note—

some of the most innovative approaches to risk management, including technical insurance tools, are initiated through the public sector and civil society (like large social insurance pools, national agricultural insurance programs, national disaster funds), or around specific sectors with specific risks (like agricultural cooperatives).

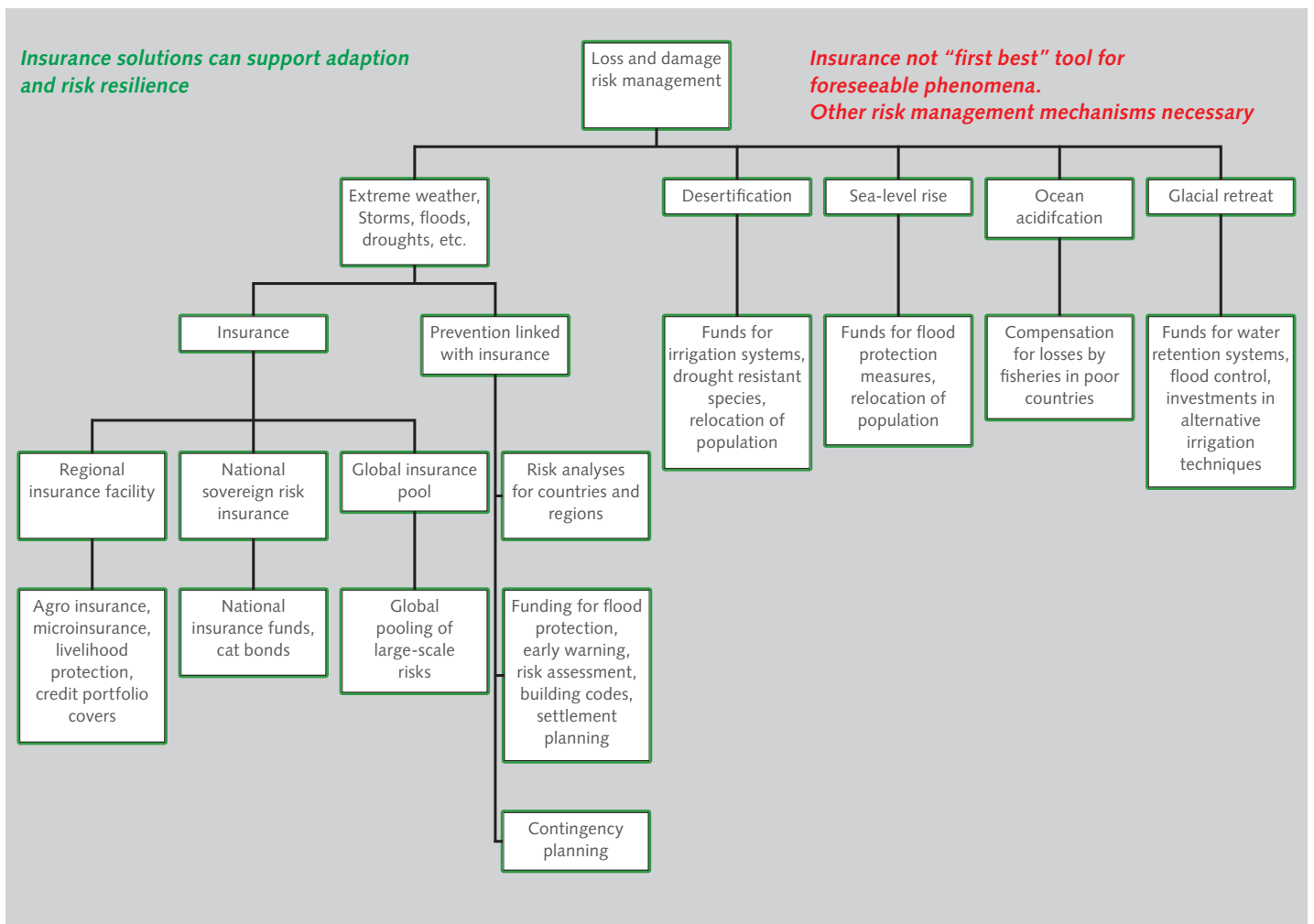
Thus, when discussing the topic, one needs to keep in mind that **each kind of actor**—public, private sectors, civil society, and a wider scope of stakeholders like science, international organizations, etc.,—**has a particular contribution to make at different stages of the development of risk management solutions.** It will seldom be the case that managing a climate risk is a purely public or private sector endeavor: public sources of information and data, private sector sources of risk management expertise, civil society sources of information about needs, all contribute to more effective risk management approaches in general, and specific approaches like insurance.

KEY MESSAGES

3. How are insurance approaches used today to address climate risks?

There are a **range of climate risk management approaches including financial tools** which can address extreme weather events and slow onset climate stressors. Regarding insurance approaches (both public and private) as a tool to manage unforeseeable risks, today most of the existing experience revolves around managing weather extremes like flooding, windstorms, drought, hail, and cyclones. It is still being discussed on how insurance approaches could be applied to also manage foreseeable, large scale climate processes like ocean acidification, sea level rise, desertification, glacial retreat, etc. These kinds of challenges may lend themselves to other risk management approaches.

From this point forward, this document summarizes **lessons learned about the use of insurance approaches in both the public and private sector** to address climate risks.



4. What are the lessons learned in implementing climate risk insurance in developing countries?

Case studies from countries including Peru, Mexico, Ghana, the Philippines, Indonesia, and the Caribbean¹ were examined to provide examples of how insurance has been used to address climate risks. Several cross-cutting lessons were identified:

- **Combinations of approaches to manage risk and build resilience.** Insurance-related tools combined with broader, comprehensive risk management approaches can contribute to building resilience with local insurance and safety nets. Combining risk transfer and other measures can contribute to protect (national, community, household) development priorities. With appropriate design, weather insurance can also complement a broader risk management strategy to reduce risk, e.g., through packaging with other services such as loans or credit, early warning, etc.
- **Focusing on livelihoods, not just assets.** Helping low-income people absorb shocks and temper downturns often involves designing insurance tools so that they protect their livelihoods – such as the provision of cash payouts to cover business interruption, or day-to-day functions – and not just a single asset.
- **Building overall risk management capacity.** The development of insurance solutions can contribute essentially to other services in the wider risk management context, including risk assessment, vulnerability analysis, risk mapping and modeling. It thus helps to enhance the technical capacities of stakeholders involved to develop risk management approaches at local, national regional and also international levels.
- **Who can insurance help?** Private and public climate risk insurance solutions can contribute to build resilience at the regional, national, community, and individual level.
- **Initial investments.** Insurance solutions as a sophisticated financial service requires a lot of start-up investment: reliable data, an insurance provider as reliable risk carrier, as well as some financial infrastructure for financial transactions (like paying premiums and making payouts).
- **The public sector can provide their experience** in using a variety of risk management approaches and distribution channels (like safety nets) to reach the most vulnerable (like subsistence farmers that may not have bank accounts or sell their products).

5. What are potential benefits of using insurance as a risk management tool?

Insurance as a risk management tool provides many **benefits** to stakeholders (ranging from regions, national governments, communities, to households and individuals). These include:

- **Decision making support** through the identification and pricing of risks. The compilation and availability of good historical and current data and its thorough analysis needed to underpin insurance solutions can generate a public good, which decision-makers can access to develop plans to strengthen the resilience of their countries and communities.
- **Incentivizing loss reduction & resilience building activities.** Increased risk awareness through the promotion and use of insurance approaches has the potential to be translated into increased risk reduction activities by individuals.
- **Reducing financial repercussions of volatility and thus creating more certainty in decision-making.** Free up governments and individuals to spend money on other investments (e.g., use of credit for productive investments in agriculture if risk is managed through insurance or provide additional policy space to introduce other services).
- **Providing timely finance to address damage** when things like floods, cyclones, drought, or other weather stresses occur. Insurance payments can provide immediate post-disaster liquidity to national governments and individuals.

6. What are the limitations of using insurance as a risk management tool?

In addition to the opportunities and potential benefits, there are a number of **limitations and risks** associated with the use of insurance products such as:

- Insurance is **not a single solution to climate-related risk**. It can only help to build resilience if combined with other risk management strategies.
- **Insurance-related approaches are not free**, and can be relatively expensive for low-income countries, communities and individuals. If no event occurs, no insurance payout will be made. This feature can make insurance a “hard sell” for national leaders with their domestic constituencies.
- Insurance-related **approaches must explicitly be designed to incentivize appropriate risk management behavior** of the governments, communities, and individuals that participate. Otherwise, undesired “maladaptive” behaviors or cheating could result (“you don’t care about your own risk because you are covered”).
- Insurance can **be complex and difficult to understand**. If not properly designed, there is, for example, the chance that some damage could occur without providing an insurance payout to participants. This can arise because of insufficient measurements of risk (like not enough weather stations to measure local variations), or because of the way insurance contracts are designed (exclusions), e.g. if a crop is damaged through excess rainfall, but only drought was covered in the agreement.

¹ For a full overview of the six case study presentations including specific lessons learned pertaining to each project, please visit MCII’s website at: www.climate-insurance.org/front_content.php?idart=3580

- Insurance requires a high degree of technical expertise to design, implement and manage insurance solutions and a certain level of awareness /education on insurance approaches for managing risk.

7. What enabling environments need to be in place for climate risk insurance?

For insurance to play a meaningful role in managing climate risks, a favorable enabling environment has to be in place including:

- **Public champions and long-term commitment** for pro-active management of climate risks. This includes a sustained public engagement with relevant stakeholders like private sector and civil society on building resilience and reducing exposure to climate-related risks.
- Facilitation of stakeholder involvement with **clarity and complementary of roles of key actors** including governments, private sector, NGOs, research institutes, and humanitarian organizations.
- **Availability of data** (ideally high-quality and open-source) for historical data sets (ideally 30 years), current weather data (ground and satellite), and future modelling.
- **Insurance carriers (public or private) with the ability to design the product and assume the financial risk, and establish distribution channels** for managing the client interaction, including education on the product, the collection of premiums and timely payouts. Ideally, distribution partners also contribute to risk reduction measures such as through education and outreach along with timely information about approaching weather systems (e.g. dissemination of early warning).
- **Appropriate regulatory environment and oversight** of insurance as a financial tool, including appropriate market conduct rules for insurance companies as well as distribution channels to improve consumer protection and prudential supervision to ensure financial soundness of the risk carrier.
- **Appropriate “back up” mechanisms** like a reserve of resources, and / or reinsurance for the primary insurance provider.
- **Investment in risk management education and careful management of clients.** This includes education and training in insurance approaches and risk reduction, financial risk management, use of early warning systems; training before potential participants sign up for coverage to ensure they are clearly informed about what is covered, how much the cost of coverage is, how much the payout would be, and how payouts it will be made, etc.

8. What is the strategic approach and reflections for climate policy?

The key recommendation is that insurance approaches should be designed and implemented as **part of an integrated climate risk management strategy**:

Governments, communities and individuals should be encouraged to **actively engage in risk reduction and resilience building measures as the priority for managing climate risks**. It is also important to introduce insurance as part of a **wider portfolio of financial options for managing risk** (e.g. cat bonds, trust funds, credit, saving schemes and the like), as well as to explore the potential for using insurance to catalyze risk reduction activities such as through **linkages with social protection and community-based risk management efforts**. Insurance solutions should also complement, and not undermine traditional coping mechanisms.

9. What is the GIZ and MCII project on “Climate Risk Insurance and Integrated Climate Risk Management Approach: Developing a Strategic Concept for the Implementation”?

The Munich Climate Insurance Initiative (MCII) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) collaborate on a project on behalf of the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety through its International Climate Initiative. The project's aim is to develop a strategic framework for low income countries and emerging economies in finding ways to implement climate risk insurance solutions in an integrated climate risk management approach. In April 2013, the project organized an expert workshop on “Climate Risk Insurance and Integrated Climate Risk Management Approach: Developing a Strategic Concept for the Implementation”, hosted at United Nations University Institute for Environment and Human Security (UNU-EHS) in Bonn, Germany. This document summarizes preliminary findings and main messages coming out of the April 2013 workshop.

For more information about the workshop visit us at:

http://www.climate-insurance.org/front_content.php?idart=3580

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