

The G20's role on climate risk insurance & pooling:

Weathering Climate Change through Climate Risk Transfer Solutions

With this document, the Munich Climate Insurance Initiative (MCII) provides suggestions on how the G20 can shape their agenda in advancing risk pooling instruments. The document is structured as follows: In a first step, major gaps in enhancing climate risk insurance coverage for poor and vulnerable countries are set out. In a second step, the question of how to enhance demand through smart support instruments is addressed by describing key messages for premium support. The third step includes recommendations on how the G20 can meaningfully advance the climate risk insurance agenda, including

- a principles based approach to climate risk insurance (p.5);
- an action plan for the G20 (p.6), and
- a global partnership on climate risk insurance (p.6).

MCII relies on past policy briefings as well as a critical review of the World Bank's G20 background study.¹

1. Climate risk insurance concept gaining traction but major gaps remain

MCII (2012)² put out the vision of a climate risk insurance facility, coordinated at an international level and implemented regionally. Such a facility would have three core functions, including a) to provide data and information for decision making and management of weather related risks, b) to provide timely financial cover and facilitate other financial risk management approaches to handle volatility related to climatic events, and c) to incentivize loss reduction and embed risk transfer into resilience building efforts. Comparing the situation in 2017 to that vision from 2012, MCII sees some progress across these three areas, with regional risk pools covering portions of climatic hazards now spanning three world regions and with increasing political commitment to such instruments.³ At the same time, there remain many gaps and challenges. The following analysis might be a helpful starting point for the debate around a meaningful G20 intervention in this regard:

1.1 Broad regional scope, limited hazard coverage

Over the last years, many more countries have received the option to be covered by a risk pool that covers part of their contingency risks in respect to climatic extremes. In terms of hazards, this includes tropical cyclones (wind and surge) in all three established risk pools, as well as extreme rainfall in the case of the Caribbean Catastrophe Risk Insurance Facility (CCRIF) and drought in the case of the African Risk Capacity (ARC). However,

¹ World Bank (unpublished): Sovereign Climate and Disaster Risk Pooling. Joining forces to manage climate and disaster risks.

² MCII (2012): Insurance Solutions in the Context of Climate Change-Related Loss and Damage, Policy Brief No 6. Available at: http://www.climate-insurance.org/fileadmin/mcii/documents/20121112_MCII_PolicyBrief_2012_screen.pdf.

³ This includes CCRIF for Caribbean and selected Latin American countries, ARC for African countries, and PCRAFI for the Pacific region.

there remains work to be done to cover additional climate-related hazard types in risk pooling instruments with a view to allow opt-in /-out into all hazards for participating governments.

In terms of regions, with the exception of South East Asia (where a regional pool is debated within the ASEAN community) and South America, all major regions with vulnerable countries are included. However, bigger economies are largely absent in these arrangements. Although individual risk pools exist in some G20 countries at the national level, no G20 country is a member of a regional sovereign risk pool.

1.2 Risk management not yet standard feature for all regional pools but first best practices emerging

Compared to MCII's vision of the three core functions of a climate risk insurance facility, most existing regional risk pools pre-dominantly focus on pooling risk and providing timely financial cover. With regard to the facilities' ancillary benefits, such as providing data on weather related risks for decision making as well as incentivizing risk reduction, some best-practice is emerging. In the case of ARC, their model Africa RiskView not only provides the basic infrastructure to trigger disbursements, it is also offered to countries working with the ARC agency as basis for national risk analysis. For example it acts as a financial early warning tool for decision-makers by informing them about expected and probable maximum costs of drought-related responses before an agricultural season begins.⁴ This can help countries to direct appropriate drought response actions and target food security investments. CCRIF on the other hand, is successively establishing itself as a regional risk managing entity, playing a role as the door-opener and potential insurance facility for meso-level insurance products. Meso-level climate risk insurance solutions, such as the Loan Portfolio Cover (LPC) developed by MCII, could provide insurance protection to financial institutions' lending portfolios that are often vulnerable to weather shocks, e.g. agricultural lending portfolios. By using subsidies as part of innovative concessional financing schemes, the donor community can encourage the uptake of meso-level climate risk insurance solutions and at the same time increase socio-economic resilience at the individual level as a trickledown effect.

1.3 Operational challenges hamper broader uptake

There are three sets of challenges that remain and that hamper further spread and uptake of regional risk pooling instruments:

- a. Co-variant risks: While regional insurance approaches lower individual countries' dependence on global reinsurance capacity and can lower premiums, regional pools are not advisable for statistically dependent (co-variant) risks that cannot be sufficiently diversified. For this reason, primary insurers, individuals, and governments (particularly in small countries) do and may need to rely on more multi-regional and global pooling mechanisms. For such cases, MCII⁵ suggested a multi-region approach focusing on top-tier level of

⁴ For further information see: <http://www.africanriskcapacity.org/2016/10/31/africa-riskview-introduction/>.

⁵ MCII (2012); See also MCII (2008): Insurance Instruments for Adapting to Climate Risks: A proposal for the Bali Action Plan, MCII Submission to Accra Climate change Talks, Ghana. Available at: http://www.climate-insurance.org/fileadmin/mcii/documents/MCII_submission_2008_Insurance_Instruments_for_Adapting_to_Climate_Risks_COP14_Poznan.pdf.

risks (1:100+ years). A similar proposal was put forward by the Vulnerable Group of 20 states in their Inaugural Statement, which calls for a sovereign V20 Climate Risk Pooling that operates at a global scale.⁶

b. Lack of key capacities: Existing regional pooling facilities report a lack of adequate in-house capacity for country interaction, client management and software development. They also note a lack of comprehensive understanding of the mechanism and parametric insurance among some key stakeholders in their member country governments. Moreover, reliable access to satellite based information, mostly administered by G20 countries, needs to be secured for parametric insurance products.

c. Lack of financial means: Existing regional risk pools face difficulties in keeping their products affordable for their member countries. Although there are several bilateral donor commitments to financially support regional risk pools through loans, a strategic approach for how to bridge existing funding gaps and secure reliable and long-term funding do not exist yet. Funding possibilities through the Green Climate Fund (GCF) should be explored - thus far, no country facilitates GCF funding to cover at least part of their premium payments.

2. Enhancing demand by smart support instruments

MCII recognizes the need for premium support for poor and vulnerable developing countries as risk adequate premiums will not be affordable to many of them. The impact can be maximized and side-effects minimized as laid out in the MCII 2016 Policy Report⁷. The key messages of this report for sovereign insurance solutions design are outlined below:

a. Direct premium support should be ‘smart’, understood as reliable, flexible, minimizing incentive distortions, and making the client aware of the true risk cost.

Smart support is characterized by the following components:

- Reliability: Reliable external support that ensures a long-term perspective for the insurance product is a precondition for the engagement of private sector actors in the market development.
- Flexibility: Premium support needs to be adjustable to factors that determine affordability of the insurance product in particular for countries with changing GNI, resilience or hazard exposure. Effectively implemented product management plans can help to adjust premium support to the factors listed, decreasing or increasing it accordingly, phasing it out when the insured are in a position to cover premiums themselves.

⁶ Communiqué of the Inaugural V20 Ministerial Meeting (2015), Available at: <http://www.v-20.org/wp-content/uploads/2015/10/V20-COMMUNIQUE-20151.pdf>. In the recent V20 chair appeal to the German G20 Presidency on climate change, the V20 note that they stand ready to discuss climate risk insurance issues and how to grow existing initiatives and make sure they benefit first and foremost the poorest and most vulnerable [<http://www.v-20.org/v20-chair-appeal-german-g20-presidency-climate-change/>].

⁷ MCII (2016): Making Climate Risk Insurance Work for the Most Vulnerable: Seven Guiding Principles. Available at: http://www.climate-insurance.org/fileadmin/mcii/documents/MCII_PolicyReport2016_Making_CRI_Work_for_the_Most_Vulnerable_7GuidingPrinciples.pdf.

- Incentives and true risk cost: Targeted premium support should minimize incentive distortions and make the clients aware of the true risk cost.

b. Indirectly reducing premiums is key to making pro-poor insurance solutions affordable and has long-term co-benefits for building a comprehensive disaster risk management framework. Measures to reduce premiums indirectly can also provide long-term co-benefits by contributing to the creation and strengthening of an enabling environment for insurance solutions as well as increasing the resilience of beneficiaries.

MCII therefore advises the G20 to use "reliability, flexibility, minimizing incentive distortions, and making the client aware of the true risk cost" as principles for smart premium support. Generally it is advisable to support the set-up and implementation of climate risk insurance schemes in developing countries and in this way reduce premiums indirectly, and primarily apply direct premium support to make insurance solutions accessible to the poorest segment of the population. For the case of sovereign risk pools this requires pro-poor contingency and disbursement plans. High-quality contingency and disbursement plans should be a condition for receiving direct premium support (e.g. including a participatory design process).

3. G20 can play a major role in advancing climate risk transfer solutions and increasing resilience of most vulnerable countries to climate change

In the context of advancing risk pooling instruments, the G20 should play the following three roles:

1. Individually, advancing risk pooling instruments in developing countries through bilateral cooperation, as well as national establishment and participation in risk pooling schemes;
2. As a group of major economies who can, based on the principles of capacity and responsibility, initiate a momentum for pro-poor climate risk insurance solutions;
3. Together with poor and vulnerable countries, to create a global partnership to effectively support vulnerable developing countries in responding to climate shocks.

3.1 A principles based approach

The G20 commitment on climate risk insurance should be framed by guiding principles to ensure that efforts actually benefit the poor and vulnerable. These principles should be based on lessons learned from existing climate risk insurance schemes in developing countries.

Applying qualitative scientific methods, researchers from MCII analysed 18 already existing climate risk insurance schemes, specifically looking at success factors and challenges, impact on resilience as well as aspects related to enabling environment. The lessons learned identified through the analysis at the micro, meso and macro level reveal common success factors for insurance schemes in targeting and reaching the most vulnerable with climate risk insurance products. We used these factors to formulate the following seven Pro-Poor Principles for Climate Risk Insurance:

-
- 1 **COMPREHENSIVE NEEDS-BASED SOLUTIONS**
Solutions to protect the poor and vulnerable from extreme weather events must be tailored to local needs and conditions. It is imperative to embed insurance in comprehensive risk management strategies that improve resilience.

 - 2 **CLIENT VALUE**
Providing reliable coverage that is valuable to the insured is crucial for the take-up of insurance products.

 - 3 **AFFORDABILITY**
Measures to increase the affordability for poor and vulnerable people are paramount to the success of an insurance scheme and also important to satisfy equity concerns.

 - 4 **ACCESSIBILITY**
Efficient and cost-effective delivery channels that are aligned with the local context are key for reaching scale.

 - 5 **PARTICIPATION, TRANSPARENCY & ACCOUNTABILITY**
Successful insurance schemes are based on the inclusive, meaningful and accountable involvement of (potential) beneficiaries and other relevant local level stakeholders – in the design, implementation and review of insurance products – creating trust and providing a basis for local ownership and political buy-in.

 - 6 **SUSTAINABILITY**
Safeguarding economic, social and ecological sustainability is crucial for the long-term success of insurance schemes.

 - 7 **ENABLING ENVIRONMENT**
It is vital to actively build an enabling environment that accommodates and fosters pro-poor insurance solutions.

MCII Pro-Poor Principles for Climate Risk Insurance⁸.

There are additional principles relevant for the G20, especially when operationalizing risk transfer approaches for fiscal risks. Some of them are listed in the World Bank's G20 background study on sovereign climate and disaster risk pooling⁹ and include the following approaches:

⁸ MCII (2016).

⁹ World Bank (unpublished): 9.

- **Ownership.** The need to promote country ownership by the countries who are engaged in the development and implementation of climate and disaster risk finance, insurance and pooling instruments and strategies.
- **Long term political commitment.** Insurance can be viewed as a contract for pre-disaster financial planning between donor and beneficiary countries. It should follow the principle of mutual accountability.
- **Financial planning, contingency management and disbursement plans.** Fiscal approaches should be accompanied by a pre-agreed disaster preparedness plan to ensure timely and efficient use of risk transfer finance.

3.2 A G20 action plan and partnership

MCII encourages the G20 to develop an Action Plan¹⁰ for climate and disaster risk finance, insurance and pooling. This Action Plan would include a set of concrete outputs to be agreed on by the participating countries, aiming to advance financial protection against climate and disaster risk in developing countries, particularly for most vulnerable people. It should be operationalized through a global partnership and incorporate lessons learned from existing schemes. The outputs could include:

- Encourage the consolidation, further strengthening and establishment of regional risk management facilities that bundle risk analysis capacities and other ancillary benefits of risk pooling mechanisms, including decision-making support tools, the association of meso- and micro-insurance schemes (including some regional risk taking capacities and the ability of channeling donor support to increase affordability of such schemes). The operationalization should be guided by a risk layering approach.
- Encourage the development and further strengthening of national catastrophe risk pools, to allow for cost-effective transfer of catastrophe risks to insurance and capital markets through public-private partnerships, in particular with the domestic insurance industry.
- Encourage the development of pre-defined and pre-agreed contingency plans that require countries to identify the optimal use of funds from a potential payout with a view to the needs of potential beneficiaries and existing national risk management structures, especially to effectively facilitate social safety net approaches in case of a disaster.
- Foster the collaboration among sovereign catastrophe risk pools – and generally a multi-country approach – to improve cost and operational efficiency and sustainability of the schemes.
- Explore options for global pooling approaches, especially for high-tiered risks, and evaluate changing cost scenarios as a result of different climate change impact projections.

¹⁰ Following the suggestion of an action plan in the World Bank background study, World Bank (unpublished).

- Generally encourage a broad spectrum of (financial) instruments and strategies against disaster and climate risks including the purposeful application of innovative concessional financing for catastrophe risk transfer and financing instruments. The instruments should be made available especially for low-income, highly vulnerable countries in order to incentivize governments to systematically build disaster risk finance strategies into their broader disaster risk management and climate change agenda.
- Encourage the international cooperation regarding relevant analytical work including data provision and data modelling and creation of necessary local and regional capacities.
- Channel relevant technical assistance to improve regulatory environments and any technical and legal work to create the necessary enabling environments.
- Provide expectations regarding the (financial support) of risk financing approaches, including the (cost) sharing of climatic risks, technical and financial support to the set-up and maintenance of risk facilities and pools, the capitalization of national and regional risk pools and other forms of (co-) financing premiums. Such expectations should follow the principles of capability, including sharing the risks imposed by climate change and responsibility for climate change impacts.
- Establish monitoring & evaluation and review protocols that ensure joint learning and that provide accountability vis-à-vis the end-users.

3.3 Expectations for operationalizing a global partnership

For any partnership to be effective, the following expectations should be fulfilled.

- It is important that the objective of the partnership supports the ambition of existing initiatives on climate risk insurance such as InsuResilience with its focus on poor and vulnerable people and the aim to cover 400 million additional beneficiaries by 2020. The partnership should be based on the narrative of the Paris Agreement and the Sustainable Development Goals to adapt to the adverse impacts of climate change and foster climate resilient development.
- The meaningful and coordinated participation of all relevant stakeholders should be a guiding principle for the operationalization of any partnership in the context of the G20 commitments. This is especially relevant for setting up effective public-private partnerships. However, a Global Partnership should particularly ensure fair access and inclusion of private sector actors from developing countries and safeguard principles such as transparent decision making structures as well as open tendering and bidding processes.
- Climate risk insurance approaches should be designed to safeguard public goods and interests. Any institutions and institutional arrangements created in the context of the Partnership should include the public interest in their mandate and aspire to contribute to creating open access data. At the same time duplication of work with existing institutions needs to be avoided.

MCII, March 2017

Authors: Sönke Kreft and Laura Schäfer

Contact: kreft@ehs.unu.edu, schaefer@ehs.unu.edu

We thank the MCII Board for their valuable contributions and comments. The authors are also grateful to their colleagues Eleanor Waters, Michael Zissener and Rachael Hansen for their support and input.

The Munich Climate Insurance Initiative (MCII) is a leading innovation laboratory on climate change and insurance. It was launched over 10 years ago in response to the growing realization that insurance-related solutions can play a role in adaptation to climate change, as advocated in the Framework Convention and the Kyoto Protocol. MCII, through its unique set-up, provides a forum and gathering point for insurance-related expertise on climate change impacts. The Initiative brings together insurers, experts on climate change and adaptation, NGOs and researchers intent on finding effective and fair solutions to the risks posed by climate change, as well as sustainable approaches that create incentive structures for risk and poverty reduction. MCII is hosted by the United Nations University Institute for Environment and Human Security (UNU-EHS) in Bonn, Germany.

