Policy Brief

PROTECTED AGAINST CLIMATE DAMAGE?

THE OPPORTUNITIES AND LIMITATIONS OF CLIMATE RISK INSURANCE FOR THE PROTECTION OF VULNERABLE POPULATIONS

In autumn 2015, the international community drew up 17 Sustainable Development Goals (SDGs). These were followed by National Action Plans established at the national level to ensure the goals could be achieved by 2030. However, climate change now stands in the path of achieving the SDGs and will specifically affect the poorest populations in the countries that are most at risk from climate change. Although extreme weather events such as tropical storms, droughts and floods threaten these people's harvests, income and livelihoods, climate risk insurance can help to reduce their vulnerability. In the event of a disaster, insurance can quickly provide funds to help the injured parties deal with their situation as well as to bolster emergency responses and strengthen social protection systems.

Despite the opportunities it provides, climate risk insurance has yet to be implemented widely in developing countries. In many places, there is little awareness of risk, sometimes people do not even realise that insurance exists, and if they do, insurances are viewed as too expensive, or the country lacks an appropriate regulatory framework. The InsuResilience initiative, which was founded in 2015 during the German G7 presidency, is an attempt to change this situation. InsuResilience aims to provide 400 million additional poor and vulnerable people with climate risk insurance by 2020. Clearly, risk transfer has now become an integral part of resilience strategies. Moreover, under the German presidency of the G20, InsuResilience could even be expanded to include further stakeholders and instruments as part of a Global Partnership for Climate and Disaster Risk Finance and Insurance Solutions. In addition, the most vulnerable countries – the so called V 20 (Vulnerable Twenty) – intend to establish a common risk pool to improve their level of protection.

Be this as it may, if climate risk insurance really is to protect the poorest and most vulnerable populations, it has to focus on people's needs, be easily accessible and, above all, affordable. The issue of affordability is closely linked to questions of climate justice: who should be viewed as liable for the costs – those responsible for climate change or the people who suffer most from it? Until now, the polluter pays principle has yet to be applied consistently during attempts to tackle climate-related loss and damage. Risk insurance and risk financing, however, could lead this to change. At the same time, solidarity is widely employed in climate risk transfer – a situation in which all insured countries take on the costs of the risks associated with extreme weather events (this is also the case with InsuResilence). InsuResilience is committed to focusing on poverty, and is currently testing options for 'smart support' aimed at ensuring that the poor can afford insurance. This focus on the poorest could be lost, however, if the planned expansion towards a global partnership is not implemented with care.

Bread for the World and ACT Alliance recommend that the German government and the G20 turn insurance into an effective mechanism to better protect poor and vulnerable populations against risks associated with climate change. In order to do so, we recommend: 1) a priority on raising awareness about insurance; legal regulation, capacity building and transparency; 2) integrating climate risk insurances into risk management strategies; 3) implementing the focus on poor and vulnerable populations as guiding principles; 4) reducing the costs of risk financing; 5) progressively ensuring that risk insurance reflects the principles of solidarity and the polluter pays principle; 6) promoting innovation through pilot projects; 7) securing ownership for

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vulnerable countries and civil society participation; 8) guaranteeing long-term financial support to InsuReslience; 9) ensuring that no support is provided to risk insurances that endanger food security, 10) drawing up guidelines that focus on poverty for cooperation with the private sector, and, 11) addressing the gaps in protection that cannot be closed through insurance.

> **InsuResilience**
> The InsuResilience initiative was launched by the German government at the 2015 G7 Summit held in Elmau, Germany. The aim was to significantly improve the protection afforded by climate risk insurance in the Global South. By 2020, 400 million additional poor and vulnerable people are to be provided with insurance against climate risks. Until now, 100 million people have received insurance: 55 million through direct insurance and 45 million through indirect insurance. However, InsuResilience seeks to ensure that five times as many people gain insurance in just five years (BMZ 2015). The German government is one of the largest donors to InsuResilience and it raised its initial commitments of over €150 million (made in 2015) by a further €40 million in 2016. This means that Germany has provided almost 40% of the initiative's funding.

Conclusions and recommendations for Germany and the G20

In its 2017 *Global Risk Report*, the World Economic Forum argues that storms, droughts and floods present the greatest risks to the world at the present time. Moreover, the report describes the confluence of risks around water scarcity, climate change, extreme weather events and involuntary migration as a potent cocktail.

The German government's intention to prioritise the issues of climate risk reduction and climate risk transfer within its G7 and G20 presidencies should be welcomed, as should its explicit reference to the most vulnerable population groups and countries in particular. Climate risk insurance can help mitigate climate-related loss and damage as drivers of poverty and, therefore, close the gaps in protection as long as they form part of a broad resilience strategy that includes risk reduction and climate adaptation.

InsuResilience, the climate risk insurance initiative initiated by the German government, represents a move towards accepting the political responsibility of climate-related loss and damage. InsuResilience is an important, albeit insufficient, step on the long road to establishing an equitable balance between those who are responsible for and those who are suffering most from the effects of climate change.

Climate risk insurance is not the only (and not always even the best) form of climate risk transfer. It is suited to the cost-effective insurance of rare events that cause serious damage, but is rather less suited to insuring against damage that occurs relatively frequently. As such, it cannot be used to insure against gradual, yet almost inevitable risks, such as those associated with sea level rise or desertification. Climate risk insurances that are properly regulated and reconciled with national climate risk management systems, and that strengthen – instead of seeking to replace – social protection systems and humanitarian emergency relief in crisis situations can indeed help vulnerable populations. However, in order to do so, climate risk insurances must be tailored to the specific needs of the poor and vulnerable while focusing on needs, transparency, access and affordability.

InsuResilience focuses on the poor and prioritises the protection of vulnerable countries and populations. However, it is still too early to judge how well its objectives will be achieved using the initiative's current conceptual and financial framework. Nevertheless, the implementation of the Munich Climate Insurance Initiative's (MCII) pro-poor principles as well as the provision of financial support to help pay for insurance premiums are fundamental issues of justice and, therefore, represent a litmus test for InsuResilience.

Bread for the World and ACT Alliance welcome the German G20 presidency's initiative to establish a Global Partnership for Climate and Disaster Risk Finance and Insurance Solutions as this could increase resilience against climate change and speed up the provision of emergency aid in the event of extreme events. In developing countries, it is the people and regions affected by climate extremes that almost exclusively take on the risks. The Global Partnership is therefore aimed at establishing a system of risk financing that would transfer risks to more countries and larger risk pools; this would reduce the cost of providing insurance. Second, in the event of loss or damage, disbursements could be made much faster than has otherwise been the case; this would partially close the existing gaps in protection that are caused by the lack of pre-financing in humanitarian aid, which delays the provision of aid. In addition, as it would shift more of the costs from the individual and national level to the collective and supranational level it would help mitigate humanitarian disasters and therefore constitute a step towards increased climate justice. Calling on the responsible parties to accept higher levels of climate risk financing in the future, would make risk financing more equitable by shifting more of the burden to those who are responsible for climate change.

The World Bank was commissioned by the G20 to make proposals on how to structure the initiative. It recommends that the Global Partnership develop instruments that support the cost of risk protection for people who live in poverty. This is essential if the Global Partnership is to benefit the most vulnerable populations and contribute towards achieving the goals of InsuResilience.

In addition to the issue of an equitable distribution of the costs, the Global Partnership also needs to help increase awareness of climate risks and the adoption of prevention strategies. It needs to increase investment in prevention to reduce the level of damage that is occurring; effective technical measures to do so include providing improved data (climatic data as well as economic calculations of climate risk) and expanding early warning systems. This would enable the Global Partnership to contribute towards a cheaper, faster and hopefully more equitable system of risk financing. In addition, it would mean that it would take the next inevitable step towards risk avoidance and better integrating climate risk management, which would ensure that the Global Partnership benefits vulnerable countries and populations.

It is still unclear whether it will be possible to anchor a focus on the poor, humanitarian aid and the protection of the most vulnerable within the Global Partnership – a broad partnership consisting of many different stakeholders such as industrialised countries, large emerging states, development banks, the insurance industry and organisations from both emergency aid and development. However, doing so is essential if the Global Partnership is to achieve its aims, and the success of the initiative will be measured on whether it is able to place the focus on the poor and vulnerable at its core.

In order to do so, Bread for the World and ACT Alliance make the following recommendations for implementation:

1. Prioritise awareness raising, capacity building and transparency

In vulnerable contexts, insurances that provide protection against climate risks are almost unheard of. Moreover, a lack of experience often results in the opportunities and limitations afforded by such insurances being misinterpreted. Therefore, campaigns that provide information should be promoted, and capacity building is needed to develop appropriate approaches in developing countries themselves. Finally, the impacts that insurance can have during disasters need to be made clearer.

2. Integrate climate risk insurance into risk management strategies

Wherever insurance is used, it must be coordinated and integrated with other forms of climate adaptation, disaster preparedness, social protection, humanitarian aid and reconstruction. As such, an overall integrated climate resilience strategy (such as the National Adaptation Plan, NAP) should be drawn up and implemented that defines the links to other policy areas, such as national development planning, plans for the implementation of the SDGs, disaster prevention plans, social protection systems, agricultural planning, national climate agreements and others. In turn, this requires the establishment of databases that can be used by stakeholders from the various sectors as well as the creation of procedures to ensure coherence.

3. Consistently implement the focus on poverty and vulnerability as guiding principles

Insurance products must be tailored to the needs of the poorest and most vulnerable populations because they bear the highest levels of relative risk. Target groups, as well as organisations from humanitarian aid and development cooperation, must be involved in the development of insurance policies.

Non-discriminatory direct or indirect access to insurance policies must be guaranteed to all population groups regardless of gender, ethnicity, social status, income or religion. The integration of national or supranational systems that protect human rights can lead to improved coherency with human rights obligations; an aspect that also needs to be enshrined in law.

Insurance must be affordable, even for very poor (state, collective or individual) policyholders or those with insufficient funds. Therefore, intelligent solutions are needed that subsidise insurance premiums or that completely cover the costs in justified cases. However, the assumption of insurance costs must not discourage policyholders from implementing measures to mitigate climate risk and avoidable risks. On the other hand, risk-based insurance premiums cannot be permitted to exclude vulnerable populations, as these are often exposed to and have no possibility of avoiding the highest levels of risk.

4. Reduce the costs of risk financing

The formation of large, regional and supra-regional multi-risk pools, ideally up to the global level, significantly reduces the cost of risk protection and should be encouraged through incentives. Supra-regional risk pools are particularly worth considering in cases where cost-effective regional risk pools are difficult to establish due to political reasons, poor data sources, small populations or homogenous risk profiles. The G20 should welcome and examine the V20's proposal to establish sovereign V20 climate risk pooling.

It is possible to significantly reduce the costs of structuring and operating insurances. The collection and provision of climate- and risk-related data as well as the modelling of risks and risk costs should be supported and promoted within the framework of the Global Partnership by the G20 and international development banks in cooperation with the World Meteorological Organization (WMO), national meteorological services, scientific institutions, specialised service providers and insurance companies. This could enable data for integrated climate risk management and data that are needed to structure insurance products to be provided as cost-effectively as possible. Best practices should be documented and best-in-class approaches used to define standards so as to reduce operational costs.

5. Progressively adopt the principle of solidarity and the polluter pays principle

Bread for the World and ACT Alliance are committed to working towards a long-term international form of risk financing that gradually implements the principle of solidarity and the polluter pays principle. Due to the huge differences in stakeholder interests, any solution will require a long process of negotiation. From the point of view of the people affected by climate risks, however, indications are already needed to credibly demonstrate that no-one will be left behind in the climate crisis. The creation of an international fund to which states, companies and other stakeholders voluntarily contribute to fund model projects that practically test the different forms of 'smart support' would send just such a message. The next G20 summit, therefore, should announce the establishment of an appropriate fund.

In the future, this fund could be expanded both in terms of the way its resources are used and the forms of funding it receives. Income from carbon pricing (emissions credits, carbon taxes, air and transport levies, etc.), which could be put in place internationally, could be used for this purpose. Other levies placed on the causers of climate change could also be used to ensure that, in the future, risk financing shifts towards the polluter pays principle. This would favour the people most affected by climate change and provide them with a more just balance between risk and damage. It would also lead to a steering effect in terms of climate-related cost-internalisation that would counteract the problem of limited resources and make the responsible parties pay the price for global warming. In addition, for reasons of fairness, it would be important that the industrialised countries' high historical levels of emissions are accounted for in the form of special payments. This could include, for example, payments being made to the Green Climate Fund (which has so far been financed mainly by industrialised countries). As it would be useful to establish a fund with capital provided by the industrialised countries to compensate for unavoidable, non-insurable loss (such as sea level rise), the Global Partnership should examine suitable options as part of a working program.

6. Promote innovation – develop pilot projects that test more equitable climate risk protection measures

Testing improved models of risk assessment, as well as directly and indirectly reducing and assuming the costs of protection (through smart support), are essential in order to close the gaps in protection against climate risks and to reduce vulnerability. Relevant pilot projects should therefore be promoted and systematically evaluated. The pro-poor principles, which provide a strong basis for the target group-focused structuring of insurance for vulnerable people living in poverty, also need to be specified, tested, and impact-assessed in pilot projects as part of different insurance products. However, the learning process will take several years because almost all current products are in their early stages of implementation and very few insurance claims have actually been made. Therefore, all stakeholders, including civil society, should be involved and the Global Partnership needs to promote an appropriate framework.

7. Promote ownership for vulnerable countries and civil society participation as principles

Ownership by vulnerable states as well as civil society participation in the development, implementation and assessment of climate risk insurance is an indispensable requirement for building and maintaining trust. In many countries concern is being expressed that climate risk transfer in the form of insurance will end up focusing on the profitability of the insurers instead of protecting the livelihoods of policyholders. The Climate Vulnerable Forum or its finance ministers, which are incorporated into the V20, should therefore be fully involved in the Global Partnership. It seems that this has not been the case until now. The large networks of non-governmental organisations involved in the provision of humanitarian aid and development cooperation have gained huge amounts of experience in providing emergency aid to the most marginalised people; as such, they also need to be included.

8. Guarantee long-term financial support for InsuResilience

Financial security creates trust and is indispensable for the success and sustainability of InsuResilience. Under the German presidency of the G20 Summit, the German government and other donors should therefore make clear that they will continue to support InsuResilience beyond 2020.

9. Provide no support to risk insurances that endanger food security

Crop loss insurance can make a meaningful contribution to climate resilience, especially for small farmers in developing countries that are particularly affected by climate change. However, insurance products that impose on farmers the use of an expensive, environmentally and climate-damaging agricultural package are highly questionable. These insurances discriminate against alternative agro-ecological approaches and seed systems that play an important role in climate adaptation and the sustainable development of smallholder farming in Africa. As such, they are unsustainable. Climate risk insurances in the agricultural sector should provide incentives for locally adapted farming methods and minimising risks, instead of endangering the livelihoods of small farmers and making them financial dependent through the use of certified seed, chemical fertilisers and pesticides. Such supplementary products should therefore be examined in detail: if they endanger food security, do not contribute to resilience or do not comply with the principles of responsible finance, they should be rejected and excluded from any form of support and cooperation from within the frameworks of InsuResilience, development cooperation or humanitarian aid.

10. Setting public regulatory frameworks to secure the focus on poverty during cooperation with the private sector

If the InsuResilience initiative aims to promote public-private partnerships in the climate insurance sector, the basic principles of climate justice and fairness as well as a focus on the poor will still need to be followed. If climate risk transfer through insurance were to be deprived of its origins in solidarity, justice and the polluter-pays principle, and instead eventually focus on opening up new markets for insurers, it would leave the safeguarding of vital basic functions to actors that primarily concentrate on making profits instead of protecting people. Therefore, it is essential that a public framework and public-private partnerships are devised that guarantee that the provision of the necessary protection is placed at the forefront of the insurance policy, and not the maximisation of profits. There is a good reason why instruments aimed at securing livelihoods such as social protection systems need public regulations, and this must also apply to climate risk insurance – subjecting them to the primacy of private companies that intend to maximise their profits would lead the quality of protection and the needs of the poorest and the people most vulnerable to climate change to be viewed as a cost factor that needed to be minimised in the interest of shareholders. Multi-actor partnerships and public-private partnerships, therefore, should be critically and independently monitored to ensure a balance of interests between the good of society and the profits of insurers.

11. Address the gaps in protection that cannot be closed by risk insurance

Risk financing and climate risk insurances cannot address all forms of risk. Consequently, it is essential that the Global Partnership openly discusses the remaining gaps in protection, such as the risks associated with sea level rise and desertification, but also in terms of the basis risk of insured losses. Finally, all participating countries need to cooperate towards developing further financial instruments so these remaining gaps in protection can be closed quickly.

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This Policy Brief is a summary of the comprehensive study *Protected against Climate Change?* (*Abgesichert gegen Klimaschäden?*) which can be accessed by following the link: www.brot-fuer-die-welt.de/themen/fachpublikationen/

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Person responsible according to German Press Law: Klaus Seitz, Berlin, June 2017