

Ensuring Climate Risk Insurance Works for the Poor

RESULTS

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Key Messages

Climate Risk Insurance – which pays out in times of drought, storm, flood or other extreme events – can benefit poor people. Rapid payouts protect vulnerable people from falling into poverty traps in the aftermath of climate shocks and disasters; the security afforded by insurance also enables people to take smarter risks and boost their productivity. However, insurance requires putting in place systems to plan for risk, so well designed insurance can be transformative, especially if it empowers marginalised people by giving them access to land or inputs.

The UN Warsaw International Mechanism for Loss and Damage, and the G7 InsuResilience initiative, aim to increase insurance coverage for the poor. To be effective in increasing resilience and helping poor people cope with loss and damage from climate change, they must adopt pro-poor principles, substantially similar to the ones in this report. And ensure a significant portion of effort is directed at micro-insurance to reach and empower poor people directly.

This paper outlines a comprehensive set of pro-poor principles to ensure that climate risk insurance works for the poor. Stand out elements of the pro-poor principles are to: meaningfully engage affected communities; establish a strong regulatory framework and foster financial education; donors should work to achieve co-benefits, such as broader financial education, and an increased capacity including in weather and data systems; open and transparent monitoring and evaluation is crucial; recognise that premium support will be required for the long term, and that transparency is essential to ensure that Climate Risk Insurance is run to benefit the poor, not to make profit.

However, an insurance approach is not appropriate in all circumstances, for instance slow onset events like sea level rise, or events occurring very frequently are uninsurable. Insurance is no substitute for social protection systems nor for disaster risk reduction and adaptation. Donors should consider insurance as one element of an overall risk management strategy and ensure their resource allocation reflects this.

Context

Loss and damage from climate change is already happening and poor and vulnerable people are bearing the brunt of it. Farmers are being forced off their land in Africa as droughts become more extreme, rising sea levels and increased floods are stealing land in Bangladesh, and increasingly fierce storms are destroying homes and lives in the Philippines, Vanuatu, Haiti and elsewhere. These

RESULTS recommends that:

- ▶ At COP22 countries should commit to increasing the political support and resources available to the Warsaw Mechanism for Loss and Damage (WIM);
- ▶ The WIM Clearing House on Risk Transfer should include independent assessments of insurance products, and develop a “gold standard” approach to tools such as insurance based on the pro-poor principles outlined in this report;
- ▶ The G7 through meeting their InsuResilience commitments should - reach the 400 million target in full; commit to the pro-poor principles in this report; recognise that insurance products will require ongoing premium support and fund these; establish an evaluation program that incorporates input from independent bodies, including civil society; and announce how much funding they will provide, by when, to micro insurance;
- ▶ At COP22 countries must agree a roadmap as to how they will meet their adaptation finance commitments;
- ▶ At COP22 countries should mandate the WIM, and the Standing Committee on Finance (SCF) to: agree a definition for loss and damage finance; undertake an assessment of how much loss and damage finance is needed and how much is being provided; explore options and put forward a plan to raise funds for loss and damage that ensures that loss and damage finance is additional to adaptation finance.

impacts of climate change go well beyond what it is possible to adapt to and into the realm of loss and damage.

In recognition of this, the Paris Agreement established loss and damage as a stand-alone element, separate to adaptation, and agreed to provide support (finance, technology transfer and capacity building) to poor countries. The Paris Agreement identified a number of areas of cooperation, including: early warning systems; emergency preparedness; slow onset events; comprehensive risk assessment and management; risk insurance facilities, climate risk pooling and other insurance solutions. The

Warsaw International Mechanism for Loss and Damage (WIM) was enshrined as the main UN body on loss and damage. Amongst other things, it was mandated to establish a clearing house to serve as a repository for information on insurance and risk transfer.¹

There remains a lot of work to be done, including developing the WIM to ensure it lives up to its mandate and provides meaningful action and support for vulnerable countries, and ensuring that vulnerable people get the support they need to cope with loss and damage from climate change.

In 2015 the G7 announced InsuResilience, an initiative to increase by up to 400 million people in the most vulnerable developing countries with access to direct or indirect insurance coverage against climate change hazards by 2020. This ambitious goal has so far has been focused on strengthening existing sovereign level insurance schemes.²

What is Climate Risk Insurance?

Climate risk insurance is a form of risk transfer mechanism designed to pay out to the policyholder when defined climate-related events take place, thus diversifying losses across people and time. This often takes the form of 'index' or 'parametric' mechanisms that pay out when specific conditions – such as the amount of rainfall, wind speed, or the greenness of vegetation in a specific geographic area – fall outside of pre-defined parameters. Broadly speaking, climate risk insurance can be implemented at three levels:

Micro-level insurance: a form of direct cover whereby individuals such as farmers hold policies and receive payouts directly. These policies may be sold or distributed via aggregator organisations such as farmers' cooperatives or NGOs.

Meso-level insurance: a form of indirect cover whereby policies are held by – and payouts made to – 'risk aggregator' organisations that provide services to individuals, such as financial institutions, cooperatives, credit unions or NGOs. In practice, this is often applied to lending organisations to cover their loan portfolio.

Macro-level insurance: a form of indirect cover whereby policies are held by – and payouts made to – governments or other agencies working at national level, in order to provide emergency funding without cutting into their regular budgets. Increasingly these schemes are operationalised through regional risk pools, such as the Africa Risk Capacity, the Caribbean Catastrophe Risk Insurance Facility and the Pacific Catastrophe Risk Assessment and Financing Initiative.

HABYARABATUMA'S STORY, RWANDA

Thirty-six year-old Habyarabatuma Phocas lives with his wife and four children in Kamonyi, southern Rwanda. A smallholder farmer by trade, he grows maize on a 2.5-acre plot. Habyarabatuma understands the growing threat of extreme weather all too well, having lost his crop to drought several times in the past. Whenever that happened, it left him without money for seeds and fertiliser and forced him to reduce the amount of land he could plant in the subsequent growing season, shrinking his income further still. Selling off the family's few goats for cash was sometimes the only option. It was a precarious livelihood.

In 2014, when ACRE Africa introduced weather index micro-insurance to his area, Habyarabatuma was sceptical – but he decided to give it a try. The timing could not have been better. That year, a drought in the first planting season triggered a payout, which allowed Habyarabatuma to invest in seeds and fertiliser to boost his maize production in the next season.

Insurance has brought another benefit, it has given Habyarabatuma access to a bank loan for the first time. When his maize crop is harvested and sold, he can comfortably repay the loan and reinvest for the next season, with more income left over for his family than ever before. In this way, micro-insurance can help to create economic security.

“Since I started taking insurance, I now have peace of mind and feel more confident when investing in my farm,”

Story courtesy of ACRE Africa

Climate Risk Insurance is primarily a tool to address loss and damage from climate change. By definition, it pays out when people suffer loss and damage from extreme weather events such as storms, floods or droughts that are increasing in frequency and severity due to climate change. Climate Risk Insurance can also contribute to resilience building (or adaptation), as resilience measures can be incorporated into the design of the insurance, for instance by providing incentives such as lower premiums for undertaking activities such as tree planting or using drought resistant seeds. The majority of the cost of Climate Risk Insurance should be considered loss and damage, hence the WIM has an essential role in delivering this.



Climate Risk Insurance: benefits and concerns

Insurance-based approaches have a number of benefits:

Protective: Insurance provides timely payments to protect vulnerable people from falling into poverty traps in the aftermath of climate shocks and disasters, especially when rapid payouts are made using parametric or index-based mechanisms. This makes sense in terms of speed and cost-efficiency as an alternative to often lengthy humanitarian responses after a disaster. For example, during the 2011 drought in Kenya, pastoralist households with

insurance were 36% less likely to distress-sell their livestock and 25% less likely to reduce meals as a coping strategy.³

Promotive: The security afforded by insurance enables people to take smarter risks and boost their productivity, building pathways to prosperity. People living in poverty tend to opt for lower-risk – but also lower-return – activities. In Tanzania, for instance, poorer farmers prefer to grow sweet potatoes (a relatively low-risk, low-return crop), reducing their earnings by 25% on average.⁴ An evaluation of weather index insurance found that insured farmers shifted production toward crops that were more weather-sensitive, but also more profitable.⁵ Similarly, many smallholder farmers may not qualify for a loan due to insufficient income and assets. Having insurance could be the difference that enables a subsistence farmer to access finance for the first time to invest in higher-productivity inputs or tools. Insurance also allows farmers to feel more confident because they know that the pay-out will protect them if their crops fail due to extreme weather. Participants in one weather-indexed micro-insurance programme in Rwanda earned 16% more income and invested 19% more into their farms than their uninsured neighbours.

Transformative: Insurance requires putting in place processes and systems needed for data-driven assessment to more clearly highlight loss and damage risks; it promotes a planned and contractual approach to risk (rather than ad-hoc crisis response); and designed well, it can incentivise climate change mitigation and resilience. To be truly transformative, insurance initiatives must empower marginalised people, including women and the landless; for example, by providing them with access to resources, such as credit, that they did not have before.⁶

An insurance approach has limitations and concerns to overcome:

No silver bullet: Insurance should not substitute for social protection systems nor for disaster risk reduction and adaptation. Rather it should form part of an integrated climate risk management strategy and broader adaptation efforts, such as social safety nets, early warning, awareness-raising programmes, disaster-proof infrastructure, and investment in more sustainable livelihoods. Without a comprehensive response, there is a danger of creating a false sense of security, encouraging unwise risk-taking and maladaptation⁷. To date donor countries have focused significant effort on insurance, and under-resourced other elements of loss and damage.

Suitable for certain events: Insurance can support resilience to unforeseeable, discrete events such as extreme weather, but is not applicable to many kinds of climate change impacts, including

ZEMADA'S STORY, ETHIOPIA



Zemada Kebeb is a smallholder farmer who lives in the village of Abraha Atsbeha in the drought-prone Tigray region of Ethiopia. Throughout her life, recurring droughts have left her and her four children teetering on the brink of chronic hunger.

However, a few years ago she enrolled with the R4 Rural Resilience Initiative: run by the World Food Programme and Oxfam America. This programme integrates four key components: microinsurance, savings, micro-credit and local risk reduction activities such as planting trees. Built into Ethiopia's national social safety net, the scheme is specifically targeted at people who were previously considered uninsurable due to a combination of poverty, lack of education and geographic remoteness.

When drought reappeared in 2012, Zemada received an insurance payout of 2,100 Ethiopian birrs (roughly £70). This sum not only covered her loan repayment but also added two sheep to the family farm, which now produce milk for her and her children.

“Thanks to the assets created through these initiatives, the environment is changing in our village,” says Zemada. “We have more water, we planted more trees and we have less heat than before.”

Story courtesy of Lorenzo Bosi, World Food Programme.

slow-onset events such as sea-level rise and desertification, or risks that occur more frequently⁸. Dedicated public funds must be made available to tackle these eventualities through activities such as flood protection; agricultural development; economic diversification; urban planning and climate resilient infrastructure; more comprehensive and flexible social safety nets; compensation; and relocation of populations when necessary.

Basis risk limitations: The index design can never be perfectly accurate, particularly when available weather data is not high-quality or granular enough. Farmers may receive a payout even when their crops survive; conversely, they may experience losses when a payout is not triggered, which creates hardship and

damages trust. This problem is called ‘basis risk’. It can never be completely eliminated, but it can be minimised through improved design of indices and products, data innovation (such as openly shared, high-resolution satellite data) and good communication so that clients are fully aware of to have a basis risk fund to supplement under payments that would lead to hardship⁹.

Spend time getting the model right: Index, or parametric, insurance mechanisms are new and complicated. Implementing them in areas where stakeholders may have limited appreciation of the role of insurance, and incomplete background information as to the model inputs required (for instance exactly what crops are grown; when rainfall is most important) may result in the



The villagers of Kabiline working in the rice fields of the valley. Rice cultivation, very important for the local economy in Casamance, has been affected by the salinisation of the soil and ground water due to drought and rising sea levels caused by climate change.

PHOTO BY JB RUSSELL / PANOS PICTURES

wrong insurance model being established. It is essential that an appropriate amount of technical support is provided in establishing the insurance model, and that a backup is in place until the insurance is fully tested.

Prioritise poor people not profit: We must be clear: the poorest people cannot afford insurance premiums. There must be no tacit assumption that the private sector will expand the frontiers of insurance to the world's poorest and most vulnerable people on a commercial basis. There is a critical role for donors to actively support the take-up of effective climate risk insurance. Few insurance schemes that benefit the poor have been started and sustained without publicly-funded premium support¹⁰. Indeed, in

developed countries, agricultural insurance is heavily subsidised¹¹. Donors should be prepared to provide long-term support to reach the poorest people that the private sector alone will not. It is imperative that subsidies benefit the poor, and do not add to the profits of insurance companies and brokers. This work must go beyond 'building markets', in which the imperative is typically to transition schemes to commercial viability as soon as possible.

Address climate injustice: Poor and vulnerable people have contributed little to the climate change problem. An expectation that they will pay insurance premiums to cover events made worse by climate change, would be unjust and contrary to the principles of the UNFCCC and the Paris Agreement.

¹⁰ Munich Climate Insurance Initiative (2015) Statement on Success Criteria for G7 InsuResilience Initiative http://www.climate-insurance.org/fileadmin/mcii/pdf/COP-21/20151204_MCI_Statement_on_Success_Factors_for_G7_InsuResilience.pdf

¹¹ World Bank (2011) Government Support to Agricultural Insurance <https://openknowledge.worldbank.org/bitstream/handle/10986/2432/538810PUB0Gove101Official0Use0Only1.pdf?sequence=1&isAllowed=y>

PRO POOR PRINCIPLES: ESSENTIAL ELEMENTS TO MAKE CLIMATE RISK INSURANCE WORK FOR THE POOR

RESULTS recommends the following pro-poor principles as a “gold-standard” for Climate Risk Insurance.

1 ACCESSIBLE

◆ **Effectively target and reach poor and vulnerable people**

◆ Micro insurance should be included, as the poorest are unlikely to be reached through social aggregators.

◆ **Sustained public funding for targeted premium support**

◆ Utilise trusted, accessible distribution channels eg: mutual and cooperatives, NGOs, input suppliers, rural banks, and mobile networks.

◆ **Embed a gender framework into climate risk insurance policy and programming**

◆ Finance for loss and damage including from innovative sources of finance.

◆ Scheme design must include women, who make up the majority of the extreme poor and are often locked out of accessing financial services.

2 HIGH-IMPACT

◆ **Ensure the insurance mechanism builds resilience and reduces poverty, immediately and over time**

◆ Track prevalence and depth of poverty, food security, nutrition and security of livelihoods.

◆ **Integrate insurance with essential livelihood activities**

◆ Monitor benefits provided and basis risk; incurred and rejected claims ratios; renewals, promptness and complaints.

◆ Institute a basis risk fund to protect policyholders.

◆ **Incentivise risk reduction and preparedness**

◆ Bundle with complementary products and services, such as: credit; savings; quality inputs, such as seeds and fertiliser; extension services, training and advice; weather information and alerts; outgrower contracts under which companies buy produce from farmers.

◆ Develop packages to suit local users’ needs and do not assume that bundling with credit is always suitable.

◆ Align insurers’ interests with mitigation and risk reduction, and the co-benefits of risk analysis and data systems such as early warning systems and contingency planning.

◆ Build resilience and adaptation activities in.

3 ENABLING

◆ **Strengthen policy and regulatory frameworks for insurance**

◆ Protect consumers, who are unfamiliar with financial services, in this new, and rapidly developing area.

◆ **Foster financial education**

◆ Outreach, education and financial skills are necessary to allow clients to judge what products will benefit them and to be aware of risks.

◆ **Build capacity through the system**

◆ In areas such as: collection and auditing of weather data; systematic contingency planning; climate risk modelling and premium pricing, marketing and distribution and claims processing.

◆ **Invest in open data systems**

◆ Build expertise and infrastructure in weather stations, climate models, yield data, livestock mortality data, and remote sensing data.

◆ Make data freely available to support disaster risk reduction and management, and enable risk-informed decisions by communities and governments.

4 TRANSPARENT, ACCOUNTABLE & PARTICIPATORY

◆ **Promote inclusive and meaningful participation of affected communities**

◆ Critical for the design of insurance schemes, contingency planning, and tracking and accountability.

◆ **Require rigorous transparency and accountability in partnerships with the private sector**

◆ Clearly allocate and define roles for public and private actors involved.

◆ Ensure additionality by requiring transparency and public participation on commercial terms of investments by, for instance, requiring (re)insurers to publish their loss ratios for products that receive premium support.

◆ **Check that insurance is the most appropriate option**

◆ Undertake cost-effectiveness and risk layering analyses to ensure the most appropriate option is chosen and that insurance is not preferred over approaches, such as enhanced social protection, where they are more appropriate.

◆ Insurance is not appropriate for very frequent events, slow onset events and social/cultural loss.

What should countries agree at COP22 in Marrakech?

In order to progress a comprehensive approach to loss and damage, that employs Climate Risk Insurance where appropriate, RESULTS recommends the following as outcomes from the upcoming COP22 in Marrakech:

Countries should fully support the WIM increasing the resources and political support to allow the WIM, supported by the Secretariat, to progress more quickly to meet their mandate of providing action and support for loss and damage.

WIM five year work plan: insurance is well embedded in the two year work program that is now drawing to a close, and should be rolled into the five year work plan expected to begin in 2017.

WIM Clearing House on Risk Transfer could offer a valuable resource to countries assessing whether insurance is the right tool, and how best to implement it. The WIM, via the Clearing House, should encourage transparency and open assessment of insurance schemes. It should be an opportunity to learn from mistakes and help develop best practice. Hence the Clearing House should include, and potentially commission, independent assessments of insurance products. The Clearing House should develop a “best practice” or “gold standard” approach to tools such as insurance – based on the pro-poor principles outlined above.

G7 InsuResilience announced at the Paris COP that they would spend \$420 million, primarily on indirect insurance schemes, most likely to be at sovereign level. At the Marrakech COP they must follow with an announcement on how they will provide micro-insurance directly to reach an additional 100 million poor people (their existing target), how much funding they will provide, and by when. Most importantly they must commit to the pro-poor initiatives outlined above, including that many insurance products to the poor will require ongoing premium support. The G7 need to establish an evaluation program, that incorporates input from developing countries and independent bodies, including civil society.

Adaptation finance roadmap: At COP22 countries must agree a roadmap as to how they will meet their Paris commitment of providing at least \$100 billion per year by 2020 of climate finance for mitigation and adaptation – with half of public finance going to adaptation. Even at this level of adaptation finance there will be a gap between what is needed, which means that poor countries can’t implement all of the adaptation programs we know would reduce loss and damage on the vulnerable.

Raise funds for loss and damage: It’s imperative that loss and damage finance doesn’t undermine adaptation finance. At COP22 countries should give the WIM and the SCF a mandate to explore options and put forward a plan to raise funds for loss and damage – that would ensure that loss and damage finance was additional to adaptation finance and, ideally, based on the polluters pay principle. There are proposals for raising loss and damage finance from innovative sources (such as aviation levies or a fossil fuel levy) that could raise more than \$50 billion annually, which deserve to be formally explored.

Scale of loss and damage finance: Countries should mandate the WIM, and the SCF, to assess how much loss and damage finance is needed and how much is currently being provided (through initiatives like the G7 InsuResilience). The first step is to agree a definition and then to undertake a stocktake of loss and damage finance and needs. Work on the definition and stocktake could happen over 2017 with input invited from countries and other organisations (for instance UNEP, academia and civil society).

Further information

For further information on the ideas contained within this briefing please contact:

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For a full discussion of the issues included here, please see:

RESULTS UK

An Introduction to Climate Risk Insurance
<http://www.results.org.uk/guides/introduction-climate-risk-insurance>

Weathering a Risky Climate: role of insurance in reducing vulnerability to extreme weather. April 2016. <http://www.results.org.uk/publications/weathering-risky-climate-role-insurance-reducing-vulnerability-extreme-weather>

Bond Development and Environment Group

Equitable, effective and pro-poor climate risk insurance: The role of insurance in Loss and Damage. September 2016. <https://www.bond.org.uk/resources/equitable-effective-and-pro-poor-climate-risk-insurance>