Munich Re Foundation
From Knowledge to Action

Loss & Damage and Climate Risk Insurance
Capacity Building and Adaptation using Financial Risk Transfer Mechanisms

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Objective

The object of this submission is to raise awareness for financial risk transfer mechanisms serving capacity building and adaption at all levels: for individuals, groups and governments.

Benefits of financial risk transfer (Climate Risk Insurance) include

- Opening a dialogue on risk and risk perception
- Creating risk awareness
- Learning about loss probabilities for different event magnitudes, giving them a price tag
- Incentivizing prevention measures and the development of coping strategies
- Creating knowledge and data for areas where often hardly data existed
- Creating more resilient structures at all levels of the society serving sustainable development.

Background

Loss and Damage is an increasingly important topic. The world at this stage is not in a position to fully avoid climate change or to sufficiently adapt to new environmental stress. Negative effects will be visible in many regions of the world and in many cases it will be the most vulnerable people at risk who suffer the most. Mainly people in developing and emerging countries will have to deal with foreseen and unforeseen losses and damages. Besides the classical instruments to address this problem – like risk prevention, disaster relief, aid and charity initiatives, political interventions – the private sector, especially the finance sector, can offer tools as well to address, avert or minimize loss and damage due to climate change. Financial risk transfer mechanisms are not a silver bullet but can serve as one pillar for coping with risk. Important: Not every climate change risk can be insured, e.g. long-term events such as desertification, glacier melt or sea level rise. However, for other important risks – such as sudden onset events, e.g. storms and floods or mid-term risks like food security – good tools for financial risk transfer and capacity building exist. In the following, Munich Re Foundation addresses existing financial risk solutions at various levels: from individual risk over community risk, up to governmental risk (sovereign insurance), being summarized as “Climate Risk Insurance”. It took a long time until financial risk transfer mechanisms – i.e. insurance – made it to the political arena. Why? Every person around the globe has an individual perception of insurance, a positive or negative one. Insurance illiteracy is wide spread. For many, insurance is just a “money in – money out” mechanism. Many don’t know the full value added by insurance systems. Insurance enables economic activity, creates awareness, creates data and incentivizes prevention. It can strengthen individuals; communities, islands, governments etc. A key benefit is: effectively managing risks before they occur (ex-ante) and avoiding impacts (ex-post).

History

In 2009 a non-profit think tank called Munich Climate Insurance Initiative (MCII) presented to the 2009 Poznan COP 14 assembly (parliament) the benefits of insurance mechanisms, highlighting the value added, and emphasizing the need for linking insurance to prevention as well as disaster risk reduction measures. During the 2015 G7 summit in Elmau, Germany, the G7 countries gave proof that insurance mechanisms officially made it to global political attention. They launched an initiative called Climate Risk Insurance Initiative

(InsuResilience), thus pointing the way towards climate-resilient development pathways. This Germany-hosted initiative aims to provide access to direct or indirect insurance coverage for vulnerable people in vulnerable developing countries. The main goal: By 2020 a number of 400 million additional people shall be covered against change-related hazards.

Risk Transfer Key Benefits

To demonstrate the value of insurance mechanisms a random example is chosen: A farmers association in Africa serving smallholders. The farmers get subsidies if they take part in a governmental yield and health program. One prerequisite for participation in the program is that the farmers invest a bearable own share. One part of the farmers' shares is kept for inclusive health insurance and also yield insurance. In case of a huge drought the farmers get a reimbursement. In case of an individual disease they can use health services in the community hospital. Such a system creates a lot of data: on the health status in the area, the quality of seeds, farming skills, climate etc. Furthermore infrastructure, e.g. a well-equipped hospital, is being built up or maintained. This includes health services utilities in the hospital but also maintenance. The farmers have paid for the risks, therefore they can claim services and losses in the case of losing yield. In the course of putting up such a system, dialogue on risk and risk prevention takes place. Increasing risk awareness is an automatic element of this approach. For a sustainable system it is important to get payments (here farmers' shares, premiums) and the cost of risk (events and shocks) right. Increased food security and overall better quality of services are a logical consequence. This little example demonstrates that insurance is not only a cash in/cash out mechanism. Systems as described in the example already exist in a number of African countries.

Scope of Insurance Mechanisms

Luckily, Climate Risk Insurance exists at all levels. Governments can insure against calamities, e.g. large windstorms, floods and droughts (so called macro insurance or sovereign insurance). Groups of people, e.g. communities, unions, mutuals, associations such as farmers associations can be insured for the same set of risks. Insurance exists for individuals as well. For example, in the Philippines more than 10% of the population are covered by inclusive insurance (formerly known as micro insurance, therefore micro level). Covered risks include health, death, funeral, property damage or loss etc.

MACRO LEVEL

For countries, even continents or groups of countries (e.g. Caribbean Islands, Pacific Islands) well-known insurance pools exist. The Caribbean Catastrophe Risk Insurance Facility (CCRIF) has been providing emergency funds to governments of affected countries shortly after disasters for more than 10 years. The Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) is a huge database for Pacific Islands to better plan for disasters and to better prepare. One part of the initiative includes financial compensation after e.g. cyclones (PCRIC). For countries in Africa the African Risk Capacity (ARC) offers drought insurance including contingency planning as a prerequisite. The private sector since the 1990s has been offering e.g. Cat Bonds for countries to better cope with losses. Payments within Cat Bonds can exceed USD 1bn.

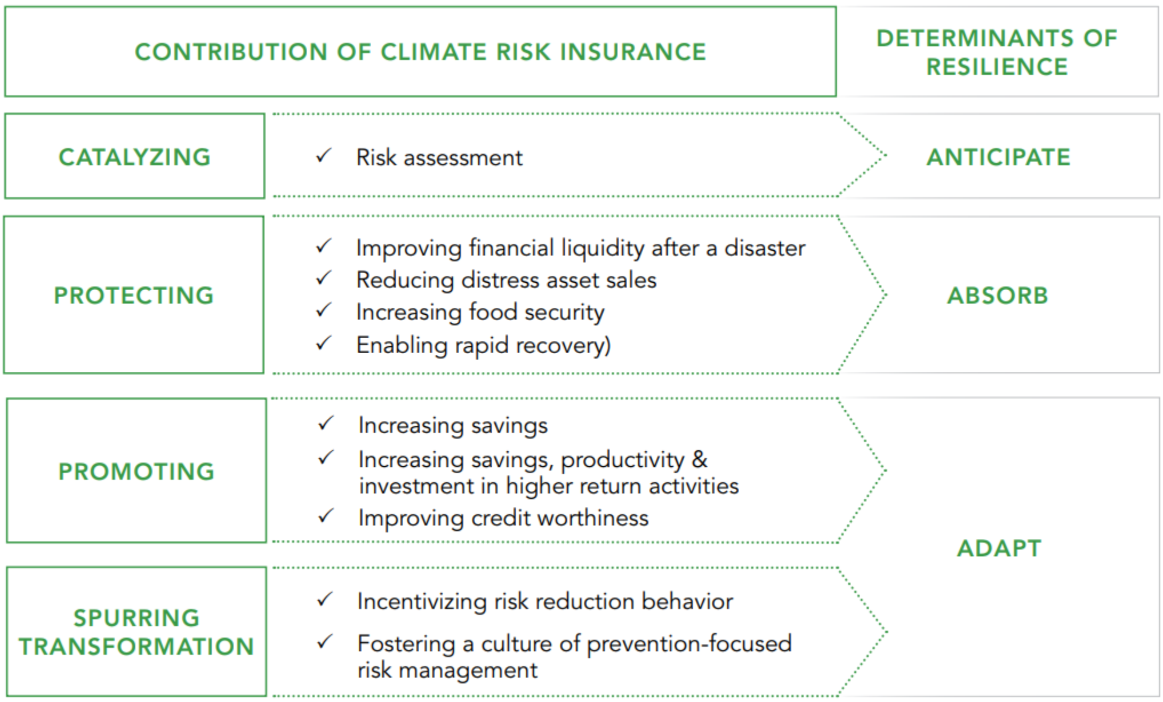
MESO LEVEL

Insuring weather risk for groups of people or communities is a widely accepted tool in all continents. One target group represents farmers who mainly insure against droughts or floods, however other solutions exist, too. E.g. securing livelihoods. A "Livelihood Protection Policy" of the MCII in the Caribbean pays to people when strong hurricanes or floods occur. A world famous program is R4 (formerly HARITA), a meso-scale scheme that operates in six African countries. R4 was evaluated, the result: R4 strongly improves farming capacity, empowers women and pays compensations in the case of bad weather.

MICRO LEVEL

Inclusive insurance on the micro level, formerly known as micro insurance, serves individuals. Risks such as health, death, education shortfall or property may be insured.
In countries such as India or the Philippines micro insurance products are widely spread and famous. In the Philippines after Typhoon Haiyan 2013 more than 100.000 people benefited from their inclusive insurance coverages. However, it must be said, that the connection to climate change challenges is stronger at the macro or meso level.

The InsuResilience Initiative mentioned above has the goal to multiply the best elements of each of the systems in order to create sustainable systems working around the globe for different cultures. The following graph summarizes the benefits of financial risk transfer solutions in a different terminology.



Source: MCII; UNU-EHS PUBLICATION SERIES, POLICY REPORT 2016, NO. 1, page 23

What we offer

Munich Re Foundation has more than 30 years of insurance expertise – in both worlds: the for-profit insurance world mostly in developed countries and the non-profit world in emerging markets where the systems mentioned above have started. Together with the Microinsurance Network (MIN) the Munich Re Foundation annually organises the world's biggest International Conference on Inclusive Insurance (approx. 400 – 500 participants from some 60 countries).

We are pleased to share our knowledge and support tailoring requests for interested stakeholders, because unfortunately one thing is for sure: the insurance illiteracy is still huge, in the political arena as well as in the NGO arena. We will support and try to help better understand the value – also shortcomings and limitations – of financial risk transfer at all levels.