Thematic Session

Financing Risk for More Inclusive Recovery

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Introduction and Background

Recovery from disaster can be a vicious circle for the most vulnerable countries, and the most vulnerable communities. Not only are they more likely to be affected by disaster, they are also more likely to suffer more severely. Disaster have disproportionate impacts on the very poor and vulnerable. RMS models suggest natural catastrophes cost the world's poorest countries almost US$30 billion a year on average.[1] And IFAD have reported that 70% of the 1.4 billion people who live on less than US$1.25 a day, live in rural areas, dependent on agriculture, and at risk of drought and flooding - in these contexts disasters have massive and cumulative effects on food security and social and economic development of the poor[2].

In addition, the most vulnerable are often out of social safety net coverage without access to social welfare, to banking, information and broader financial services. Similar to the concept of poverty traps, with the most vulnerable remaining in a cycle of vulnerability over generations. Disasters may have consequences affecting daily life leading to precarious coping strategies such as "reducing food consumption, taking children out of school, borrowing money, withdrawing their retirement fund and selling assets." [3] The coping strategies have the potential to lock the most vulnerable in poverty and vulnerability for generations.

Recovery from disaster for the most vulnerable often contributes downward spirals of vulnerability and poverty: starting at a point of significant impact, vulnerable communities do not have the resources needed to recover successfully and can be dragged into an ever-worsening cycle with each subsequent disaster; weak recovery can often exacerbate the already heavy impact of the disaster.

> "Poor people are not only more vulnerable to natural hazards, they also tend to have access to fewer post-disaster support mechanisms, such as insurance, borrowing, or remittances, and have fewer savings to draw on. As a consequence, they tend to experience higher losses

[1] https://www.rms.com/blog/tag/centre-for-global-disaster-protection/
[2] https://www.ifad.org/documents/38714170/39150184/Managing+weather+risk+for+agricultural+development+and+disaster+risk+reduction.pdf/f71b7b63-0b05-445e-a474-fc1c827e72a1
[3] http://www.pfip.org/newsroom/press-releases/2019-2/6457-2/

> relative to income, and often have to resort to "negative coping mechanisms" such as reducing food intake, cutting down on health care, or reducing education spending" (p. 27)[4]

Recovery is multidimensional, complex and deeply challenging undertaking, for country and community, family and individual, and often forces choices to be made that would not otherwise have been taken, as recovery from impact is balanced with every-day living and development. Recovery that is resilience needs, therefore, to be not only an integrated part of disaster risk management but also of long-term resilience building and development.

The innovative financing of risk can be a key tool in tackling the complex issue of recovery, especially in the case of the most vulnerable, not just looking to ensure recovery is swift, but building long-term resilience[5]. Improved access to financial services can help people to adopt risk reducing measures and build long-term economic resilience. The regional RESPAC initiative of the Pacific Financial Inclusion Programme summarizes the role of insurance as followed: "Greater insurance penetration will lead to greater levels of resilience"[6], because individuals and businesses will suffer less from liquidity constraints, hence have the financial ability to recover faster. Businesses can restart operations earlier and individuals would not need to use other financial assets.

As an outcome, one of the critical routes to delivering on that resilience, especially for the vulnerable, is to provide access to micro/inclusive insurance, because it not only provides for coverage of key areas of life and living, but can increasingly be used to 'connect' the financially excluded to the critical world of finances, credit, pensions and more[7].

Here too is another inter-connection relevant to the insurance and risk financing discussion, which is how it can add to and compliment social welfare in some of the most vulnerable locations.

Issues related to the topic

At WRC4 in May 2019, a panel comprising of representatives from the government, public, private and development sector will look at how risk financing can be a tool for inclusivity in the recovery process, combatting the way in which disasters often work to further isolate the most vulnerable countries and communities. A set of key questions will drive the discussion:

- Why is financing a key tool to unlock resilience for the most vulnerable?
- What are the principals by which investments in new, innovative and scaled up financing mechanisms, need to be developed and implemented?
- What does this mean for the key area of agriculture, which is heavily affected by disaster and is often a critical issue for the most vulnerable?
- What are the innovations that are or have the potential to drive change for the most vulnerable in the context of recovery?
- What is the role of both public and private, international and national actors in tackling this long-standing issue?

[4] https://www.gfdrr.org/sites/default/files/publication/Building%20Back%20Better.pdf

[5] "Rigorous research has found that improved access to formal financial services can help people become more resilient. Resilient households adopt risk reducing measures that help mitigate the catastrophic consequences of shocks; they demonstrate preparedness for future economic shocks; and they are able to smooth consumption without resorting to costly coping strategies, such as taking on unsustainable levels of debt or selling productive assets". https://www.poverty-action.org/sites/default/files/publications/Building-Resilience-Through-Financial-Inclusion-January-2019.pdf, p. 1

[6] RESPAC – Insurance based solutions for disaster resilience http://www.pfip.org/our-work/work-streams/financial-innovation/respac-insurance-based-solutions/

[7] Take the example of the Pacific islands where UNDP estimates "that around 6.5 million people or 80% of people lack access to financial services (i.e. savings, credit, insurance, remittances, transfers, pensions and investments) from either regulated or non-regulated financial institutions. The majority of those excluded from the financial sector are not able to achieve their full economic potential and continue to be denied opportunities to attain a productive and dignified living."- Pacific Inclusion Programme Concept Note https://www.undp.org/content/dam/fiji/docs/ProDocs/PFIP2%20ProDoc%20UNDP_UNCDF.pdf, p. 6

- What can be done before disaster strikes, to lessen likelihood and severity, and increase resilience?

In this section of the background paper we examine some of these key questions by articulating some of the key principles through which risk financing and insurance can broadly contribute to inclusive recovery. It is not a comprehensive review but rather provides some of the entry points for a further discussion on risk transfer, insurance and recovery. There is a particular focus on agriculture insurance, because agriculture is heavily affected by disaster and is often a critical issue for the most vulnerable, being dependent as they often are on subsistence.

Inclusive, Impact and Micro: What do we mean?

The focus of this event at WRC4 is on 'inclusive recovery' and particularly the financing approaches and tools that can be utilised to build the resilience of the most vulnerable. Broadly speaking the terms inclusive, impact and micro-insurance are the same. Inclusive insurance is insurance designed for low – income people to match their needs[8], with a focus on vulnerable communities[9]. ILO uses the term impact insurance as a broad umbrella term to denote different approaches to using insurance to support vulnerable communities, whereas the term inclusive insurance focuses more on the vulnerability of communities such as women, elderly, displaced and people with disabilities and includes social protection aspects.

And micro-insurance has a broad definition that revolves around provision of insurance to the poorest, often those who have difficulty to pay 'traditional' insurance, and therefore pay for coverage in small fractions of what might be typical for a middle-income family. Almost any kind of insurance, health, life, employment, agriculture, car and more can be what we call micro or inclusive insurance.

Broadly speaking therefore, these terms are inter-changeable. This kind of insurance increases financial protection when a disaster hits and encourages the use of more effective, efficient financing when a shock occurs; it improves health through the utilization of healthcare services in terms of frequency and timing; it covers the income of a head of household in the event of disability; it protects household contents from theft, fire or damage; and much more, and especially for those who can least afford the impact of uninsured-risk.

Index-Based Agriculture-Insurance

Inclusive insurance should serve the most-vulnerable, under and unserved population with appropriate and affordable insurance products. One key financial instrument for vulnerable rural communities is indexed agriculture insurance, which is based on some kind of trigger being reached (such as rainfall or temperature) rather than any direct loss to the insured assets. Traditional crop insurance schemes have at times been ineffective and costly. In countries with no agriculture or disaster insurance, index insurance is promoted as valuable alternative to protect the poor from various shocks[10]. The narrative is based on the public display of indexes, its transparency and therefore its objectivity. The very poor may benefit from agriculture insurance on different levels. On the one hand insurance enhances family's food security by providing a financial safety net. On the other hand, agriculture insurance enables, in theory, increased investments in agriculture practices, which leads to an increase in GDP and benefit the vulnerable population in the long run.

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[8] http://www.impactinsurance.org/about/what-is-impact-insurance

[9] "We define inclusive insurance as access to and use of appropriate and affordable insurance products for the unserved and underserved, with a particular emphasis on vulnerable and low-income populations" – https://content.centerforfinancialinclusion.org/wp-content/uploads/sites/2/2018/08/Inclusive-Insurance-Final-2018.06.13.pdf, p. 6

[10] For example, the agriculture sector in Kenya experienced losses and damages of over 10 billion USD between 2008 -2011 caused mainly by drought. The 2010 floods in Pakistan caused 5 billion in damages and losses to the agriculture sector; see http://www.fao.org/3/a-i5128e.pdf

Role of public and private, national and international organisations

Insurance must be embedded in a broader financial inclusion framework to help the very poor. It is a cross-cutting issue, and one where roles are diverse but interconnected, international and national, public and private, each with their role to play. Successful inclusive insurance schemes, which support the very poor should therefore rely on the integrated involvement of relevant actors. Below a short and brief sketch of the different roles' actors should take:

1) Private sector: Provision of distribution channels, product development and deployment, development of critical beneficiary data-sets.
2) Mutual and Cooperative Sector: Distribution, product development and deployment, data sets. Integration into wider financial inclusion initiatives.
3) National government: Political leadership, integration into national country strategies, creation of an enabling environment through necessary legislation and regulations, institutional capacity and oversight, where appropriate provision of premium subsidies.
4) International organizations: technical assistance, capacity building, government partnership, regulatory and institutional development, partnership management, convening and partnership.
5) Donors: Support to government and international agency leadership, financing of critical investments in capacity development, where appropriate premium subsidies.

Integration into Disaster Risk Management and Climate Adaptation

It is clearly not possible for the very poor to manage all of their risks through insurance. And development itself will not be delivered through insurance alone, no matter the quantity or quality of the insurance products and coverage on offer. For development, a much more integrated approach is critical, one that integrates all aspects of risk (including risk transfer through insurance) into long-term risk management and development strategies.[11] Inclusive recovery needs therefore to be adequately integrated to tackle the risk and development needs of the most vulnerable.

Risk financing and insurance should be integrated into all aspects of a country's planning and delivery of resilient, sustainable development. Insurance alone, without the necessary risk reduction, will never be able to tackle the full nature of risk; and unless integrated into broad development, insurance could be seen a way to transfer the responsibility for development from government to the private sector. Appropriate integration is critical - integration highly dependent on the context.

Inclusive insurance works well as a resilience building tool when offered within a bouquet of services. To be truly effective, all issues of risk need to be built into not only the product but also the measures of reduction of risk, and the integration of risk into long-term development strategies, including at community level. One particular reason why inclusive insurance is useful, for example, is that it localises issues of risk and development much more strongly that sovereign risk schemes.

Insurance and Social Protection

There is an important overlap between social protection schemes and insurance for the most vulnerable, but the overlap is mostly complimentary. Social protection policies aim to reduce poverty, inequality and vulnerability[12] and involve social assistance, access to health care or income security and can include an insurance component. Insurance can be part of social protection schemes, each covering different risks. For example, the Insuresilience Global partnership published a policy paper on linking climate risk insurance with shock-responsive social protection. The policy paper emphasises the

[11] http://www.impactinsurance.org/sites/default/files/CB13-EN.pdf

[12] https://www.insuresilience.org/wp-content/uploads/2019/03/insuresilience_policybrief_1-2019_190312_web.pdf, p. 3

need of a risk layered approach[13] combining social protection and insurance components. This approach could help to cover the immediate need for financial liquidity with the long-term need of social protection. For example, the Kenyan hunger safety net programmes combines insurance with social safety net approach. Farmers can access insurance programmes by participating in risk reduction activities and a cash-for-work program. If insurance is embedded in a multi-layered risk approach that includes social protection, the vulnerable community might benefit from it the most. In addition a briefing note from the USAID supported Innovation Lab for Assets and Market Access explored how a resilience-based approach to social protection, that includes insurance, can be a sustainable way to manage the impact of climate change on rural households[14].

Challenges for Inclusive Insurance

Despite some clear uses for inclusive insurance as part of a broader package of risk management and sustainable development, there are, however, clear challenges in developing countries, and we outline some of the critical ones below:

- Premium Subsidy Dilemma: Poor and vulnerable families can use insurance as a tool to alleviate liquidity constraints. The problem with access to the insurance might be the high premiums, resulting in low take-up[15]. Premium subsidies would be a solution to solve the problem. The problem is, that high premium subsidizes might decrease risk awareness, hence increase moral hazard[16].
- Risk Coverage: Insurance is generally more suitable to cover idiosyncratic risk, with low frequency but high intensity. Oxfam points out that disaster insurance is not likely to be cost-effective for disasters that occur more frequently than about once in seven years.[17] Furthermore, climate risk insurance often covers a limited amount of risk, skewing the reality that the very poor may have to deal with several risks not covered by the insurance scheme but triggered by climate related events such as pest, diseases etc.[18]
- Basis risk[19] is a particular challenge for index insurance. The mismatch between the index measurement and the actual losses is the result of poorly designed products and geography. It should be, in the ideal world, highly correlated with covariate losses, but also be exogenous[20] and available at low cost - to serve the interest of the insurance company.
- Lack of data: In order to design appropriate and robust insurance products, high-quality long-term historical data is needed. Often this data is not available or easily accessible.
- Lack of understanding: Often there is little culture of insurance present. Education is needed to inform the very poor on the benefits and drawbacks of insurance schemes, so that they can make

[13] Ibid. 'Risk layering' refers to the process of separating risk into tiers that allow for more efficient financing and management of risks (World Bank, 2012). Financial instruments and risk prevention and reduction measures should be chosen on the basis of frequency and severity of events. For weather-related risks which happen often but which are less severe, preventative and risk reduction measures may be the most cost-effective option, while the more severe and less frequent risks could be transferred to private and public insurance markets (Schaefer et al., 2016), p. 4

[14] https://gallery.mailchimp.com/6e44e7d9ff174776d0f2af089/files/9e4c5f54-3151-4170-957a-5b1b0d85ffd4/AMA_Brief_Carter_Janzen_Social_protection_resilience.pdf

[15] Ibid. **"**There are however limits to insurance as a tool to manage climate risks. While the poor and vulnerable are often most impacted by climate-related shocks, they are also often unable to access insurance and other market-based instruments, unless premiums are subsidized or other supporting measures are provided. In addition, insurance is generally more suitable for weather events that occur with low frequency but high intensity. Covering the impacts of weather-related events that occur with very high frequency, such as recurrent excessive rainfall leading to floods, would mean disproportionately high insurance premiums.", p.3

[16] Moral hazard commonly refers to the role of the insurer and its behaviour after the purchase of an insurance product.

[17]https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620457/bp-facing-risk-climate-disaster-insurance-160418-en.pdf;jsessionid=307BC18A3B18A721BC6A14791283B9A3?sequence=13

[18] https://us.boell.org/sites/default/files/not_a_silver_bullet_1.pdf

[19] Basis risk refers to the imperfect relationship between the indemnity payments made by an index policy and the actual insured losses experienced by the policyholder.

[20] Exogenous means not correlated with actions of the farmer. If the signal correlates with farmers' action it is endogenous and not suitable for index insurance.

an informed decision. The issue ties into other aspects such lack of trust or low take up to name a few.

- Legislation, Regulation, Institutions: Legal and regulatory frameworks in developing countries are often insufficient and frequently inconsistent. Willis Tower Watson reports that most Sub-Saharan African countries find regulation, even when well drafted, very hard to implement and enforce, as supervisory bodies have almost no actual oversight.[21] These issues are compounded by the face that less than a quarter of adults in Sub-Saharan Africa have access to formal financial services of any kind, with insurance one of many missing features of their financial life.

Conclusions

Inclusive insurance, as part of a joint effort of different partners, supports the delivery of the SDGs. Since 2015, financial inclusion (of which insurance is a key part) has been identified as an enabler for 7 of the 17 Sustainable Development Goals (SDGs). In 2016, the G20 committed to advance financial inclusion worldwide and reaffirmed its commitment to implement the G20 High-Level Principles for Digital Financial Inclusion. Microinsurance is today considered as a central component of climate change adaptation measures and as a catalyst to tackling poverty, if combined with other financial services, and a report by GIZ notes that inclusive insurance directly supports delivery of 6 SDGs and contributes significantly to another five[22].

Inclusion should be an integral part of disaster risk management to effectively include the very poor. The development and expansion of insurance services that are socially inclusive, particularly targeting the vulnerable, underserved and single-headed female households, are critical to reduce the vulnerability of the furthest left behind and increase their resilience in the face of disasters. More than that, they are critical to ensuring that development is truly sustainable for all in society.

In addition to the direct and indirect value it may provide to clients, microinsurance often has significant social value, in the form of market or economic development, as families and communities are increasingly connected with more beneficial financial products and services. Studies have demonstrated a causal link between the development of the insurance industry in general and overall national economic development. By mobilizing savings, insurers are an important source of long-term investment capital for initiatives such as infrastructural improvements and can stimulate the development of debt and equity market.

Secondly, micro-insurance is delivered through adapted distribution channels and connected to a range of other products and services (such as loans, savings and pensions to name but a few), connecting people to wider society and economic advantages in a way they would not otherwise have experienced. Although the financial industry has advanced remarkably over the past thirty years, close to one-third of adults – 1.7 billion – are still unbanked according to the latest Findex data[23]. About half of unbanked people include women poor households in rural areas or out of the workforce.

And finally, critically, insurance can be a peace of mind mechanism to enable the very poor to live a dignified life, knowing their life and livelihoods are properly protected from the vicissitudes of daily

[21] https://www.towerswatson.com/en/Insights/Newsletters/Global/Emphasis/2016/emphasis-2016-2-insurance-demand-in-sub-saharan-africa-tempts-multinationals

[22] https://www.microinsurancenetwork.org/sites/default/files/Inclusive%20Insurance%20and%20the%20Sustainable%20Development%20Goals%20.pdf

[23] https://globalfindex.worldbank.org/

life, as well as enabling them to make choices they would not otherwise have made because they know a key aspect of life and living was covered.