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Concessional Support for Climate and Disaster Risk Finance and Insurance

Discussion Paper by the InsuResilience Global Partnership Secretariat

Discussion Paper for the High-Level Consultative Group (HLCG)

This discussion paper is prepared by the Secretariat of the InsuResilience Global Partnership ("Partnership") based upon a synthesis of evidence commissioned by members and initial consultations with members. Concessional Support for climate and disaster risk finance and insurance ("CDRFI") is a complex, sensitive and evolving area of work that is of high strategic relevance to the vision and objectives of the Partnership. This paper (i) illustrates the role of concessional support, (ii) summarizes potential forms, and (iii) its purpose in the context of the Partnership.

(i) The role of concessional support in promoting financial resilience of vulnerable populations

It is broadly recognized by policymakers around the world that CDRFI, when embedded in a comprehensive risk management framework, can help vulnerable countries manage the risk from climate and disaster shocks more effectively. Financing tools like sovereign risk transfer solutions can lead to faster, timelier, cost-effective, and more reliable response and recovery (Clarke, 2017).

Despite the benefits, the upfront costs of CDRFI instruments can create a barrier to the use of these instruments, particularly when compared with other development investments that can deliver larger, more certain returns (Schaefer & Waters, 2016). The political incentives can also be an issue and countries may lack the institutional frameworks and capabilities to buy and use sovereign-level insurance coverage (CCRIF, 2015). Those countries most vulnerable to climate and disaster shocks, are often most limited in their financial and other capacities to access CDRFI (Narube, 2015).

Providing concessional financing (e.g. premium finance or paying down interest rates on contingent loans) can support the use of CDRFI within a comprehensive risk management framework. The definition and arrangement of suitable mechanisms is an area of joint work within the Pro-gram Alliance - the Partnership's alliance of implementing programs.

(ii) Overview of potential forms of concessional support

Countries seeking for financial protection through CDRFI can be supported either directly via financing of insurance costs, i.e. premium payments, or indirectly by optimizing those element that drive insurance costs. As risk transfer attaches a price tag to a risk, insurance costs are primarily driven by technical elements: the underlying risk (as assessed by a catastrophe risk model), the costs of capital to reimburse those providing the necessary capital for the insurance vehicle, and the administrative and transaction costs needed to operate the insurance mechanism. In addition, premiums are also driven by market supply and demand mechanics when the private (re)insurance industry is involved to provide the necessary risk capacity[1].

Building up on the above, several forms of concessional support may be considered to support countries in using CDRFI. Beyond those that reduce insurance costs, the provision of concessional grants or credit, as a complementary instrument to insurance, is another possible mechanism to be considered (World Bank 2017). The box below provides an overview of the different options available.

Set of concessional support tools:

- **Premium financing**: direct grants or concessional loans to countries for a portion of insurance premiums
- **Capitalization:** Provision of concessional capital (equity or debt, e.g. with reduced or no interest) necessary to ensure adequate solvency of insurance vehicles
- **Payment of reinsurance premiums** required for efficient reinsurance coverage of a risk pool, including coupon payments for catastrophe bonds
- **Subsidizing operational costs**, incl. administrative, transaction and start-up costs
- **Technical Support and Capacity Building**, incl. modelling, product structuring, risk know-how and market development
- **Financing risk reduction measures** that lead to foreseeable reductions in annual average losses and therefore savings in premiums
- **Concessional credit,** e.g. via reduced interests for contingent credit instruments

(iii) Purpose of concessional support

Concessional support will generate maximum impact if it is applied in line with standards that set the right incentives for sustainability, target the poorest and most vulnerable people, and crowd-in the private sector.

[1] Sovereign risk pools, for example, while established with public funds, may still require the use of private sector reinsurance capacity, which means that reinsurance markets can also influence the price of cover.

Therefore, as a first approximation, the use of the tools listed above should be guided by the Partnership's Pro-Poor Principles (see detailed Pro-Poor Principles in the separate HLCG document):

- **Impact** for poor and vulnerable people, i.e. by giving priority in obtaining support to the poorest and most vulnerable countries, but also showing a clear path to sustainability when support is phased out
- **Quality** of climate and disaster risk finance solutions: concessional support should be embedded within actuarially sound insurance products and build on best available techniques that are fit for purpose
- **Ownership** by the country for the instrument: concessional financing should support demand-driven solutions that inspire the participation of all stakeholders
- **Complementarity** with other instruments and risk management strategies, building on existing institutional frameworks and ensuring clear linkages of insurance or risk finance payouts to disaster response plans that help reach affected populations rapidly and effectively
- **Equity** via an inclusive approach that promotes equitable growth, leaves no one behind, is gender inclusive and promotes basic human rights.

Way forward

The use of concessional support tools to support CDRFI is a relatively new field that should follow a flexible approach as countries and implementing partners continue to learn which systems and strategies work best. As evidence is built through a growing track record, countries and development partners will be able to refine operational modalities to ensure maximum impact and sustainability, and to better manage risks associated with concessional support mechanisms, such as setting wrong incentives for preparedness, risk taking and sustainability. The Secretariat will continue to promote knowledge exchange around this area of work within the Partnership, drawing from experiences made within the Program Alliance and other programs, and facilitating new analyses to address specific knowledge gaps. For the time being, the HLCG is welcomed to address which specific issues around concessional support should be analyzed further, and which priorities it suggests for the implementation of concessional support in the CDRFI landscape.

References

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