

**Policy Note**

# Integrating Risk Finance into National Resilience and Adaptation Efforts

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## Executive Summary

The increasing frequency and severity of disasters as a result of climate change threatens lives and livelihoods, food security, water supply, property security, and economic prosperity across the globe. Adaptation is vital to make society resilient to the impacts of climate change. This **Policy Note** examines how risk financing considerations can enhance vulnerable economies' resilience efforts if integrated into national adaptation and investment processes, and efforts to address loss and damage. References are made to three instruments under the United Nations Framework Convention on Climate Change (UNFCCC): NDCs<sup>1</sup>, NAPs<sup>2</sup> and adaptation communications<sup>3</sup> (adcoms). NDCs are at the heart of the Paris Agreement adopted at the UNFCCC

conference in 2015. The goal of the Paris Agreement is to transform countries' development trajectories towards limiting warming to 1.5°C above pre-industrial levels, and to increase their long-term ability to adapt to the adverse impacts of climate change. As such, NDCs can provide a blueprint for countries' development and complementary investment strategies. NAPs are action plans that guide national adaptation actions across sectors and inform the preparation of adaptation communications, including when communicated as components of NDCs. The process to formulate and implement NAPs (NAP process) serves to help developing countries to identify medium- and long-term adaptation needs and to develop and implement strategies

1 Nationally Determined Contributions.

2 National Adaptation Plans.

3 Recalls that, as provided in Article 7, paragraphs 10 and 11, of the Paris Agreement, each Party should, as appropriate, submit and update an adaptation communication, and that the adaptation communication shall be, as appropriate, submitted and updated periodically, as a component of or in conjunction with other communications or documents, including a national adaptation plan, a nationally determined contribution and/or a national communication.

and programmes to address those needs. Adaptation Communications are country-driven communication instruments in which countries may provide an overview of adaptation priorities, implementation and support needs, plans and action, and progress and results achieved.

Drawing from an analysis of vulnerable countries' needs by the NDC Partnership Support Unit, the Note concludes that integrating risk financing considerations into resilience and adaptation planning can enhance investment decision-making in the context of climate change. This is in addition to strengthening countries' financial resilience and closing the protection gap for vulnerable people to climate shocks and disasters. Risk analytics and pricing techniques help finance ministries and other decision makers in setting resilience baselines, understanding investment risks and gaps, and assessing cost-effectiveness of different resilience-building options, which ultimately help capture the true value of investment activities.

## 2

# Introduction

Climate resilience building and emissions reductions are critical to avoid the worst-case scenarios projected by the Intergovernmental Panel on Climate Change (IPCC). Within the processes of the UNFCCC and the Paris Agreement, countries can use different planning and communication instruments to support these efforts. This Policy Note focuses on three of them: the adaptation components of the Nationally Determined Contributions (NDCs), National Adaptation Plans (NAPs) and Adaptation Communications (adcoms), acknowledging that other planning instruments for achieving the targets of the Sendai Framework for Disaster Risk Reduction are also important for risk-informed development.<sup>4</sup> It is a joint effort by the InsuResilience Secretariat, the CVF-V20<sup>5</sup> Secretariat, the NDC Partnership

The **Policy Note** suggests the following action areas for the InsuResilience Global Partnership to be taken forward in cooperation with other partners and initiatives:

1. Raise awareness and support advocacy for the benefits of integrating risk finance instruments and strategies into national resilience and adaptation efforts
2. Enhance capacity building across in-country institutions
3. Strengthen availability and access to data, information and knowledge to model resilience baselines and set investment targets
4. Promote country-driven access to private sector expertise and capital
5. Disseminate good practices

These action areas were endorsed by the InsuResilience Global Partnership's High-Level Consultative Group (HLCG) on September 15th, 2020.

Support Unit, the Munich Climate Insurance Initiative (MCII), and the UNFCCC to demonstrate the importance of integrating risk finance strategies and instruments, including mechanisms underlying the design of such instruments, into national resilience and adaptation efforts.

NDCs are at the heart of the Paris Agreement, adopted at the UNFCCC 21<sup>st</sup> Conference of the Parties in 2015, which aims to transform countries' development trajectories towards limiting warming to 1.5°C above pre-industrial levels. NDCs serve to communicate countries' highest possible ambition with a view to achieving the purpose of the Paris Agreement<sup>6</sup>, including through mitigating greenhouse gas emissions and adapting to the adverse impacts of climate change,

4 This Policy Note focuses on climate policy and specifically adaptation planning as a framework to strengthen resilience. While it does not make explicit references to the Sendai Framework for Disaster Risk Reduction (DRR), the authors acknowledge its relevance for resilience efforts in vulnerable countries. Upon endorsement of this Policy Note, the InsuResilience Secretariat would seek to engage with UNDRR and other interested parties to explore risk financing benefits within the Sendai Framework, and how findings of this note can support respective targets and in-country processes.

5 The Climate Vulnerable Forum (CVF) is a global partnership of countries that are disproportionately affected by the consequences of global warming. The forum addresses the negative effects of global warming as a result of heightened socioeconomic and environmental vulnerabilities. The Vulnerable Twenty (V20) Group of Ministers of Finance of the Climate Vulnerable Forum is a dedicated cooperation initiative of economies systemically vulnerable to climate change.

6 Derived from Articles 3 and 4.2 of the Paris Agreement.

while making financial flows consistent with low carbon and climate-resilient development.

Adaptation communications serve as an overview of a country's adaptation priorities, implementation and support needs, plans and efforts, as well as progress and results achieved to:

1. increase the visibility of adaptation
2. strengthen adaptation action and support for developing countries
3. input into the Global Stocktake
4. and enhance learning and understanding of adaptation needs and actions.

NAPs are the national instruments for adaptation that help developing countries to identify medium- and long-term adaptation needs and to develop and implement strategies and programmes to address those needs. Mitigation, adaptation, disaster reduction, response, and recovery as part of comprehensive approaches to risk management are key to averting, minimizing, and addressing loss and damage. They require multi- and cross-sectoral approaches and they need to be anchored in a country's development planning. The preparation and communication of NDCs present a powerful framework to inform national investment strategies for long-term development. Given the many co-benefits between mitigation and adaptation, NDCs can include quantitative sectoral investment targets for resilience efforts, which ensure that investments made today deliver economic outcomes, while not exacerbating the climate crisis in the future. By specifying support needs in the form of conditional contributions,<sup>7</sup> they help to mobilize international support to implement these investments, including for risk financing instruments.<sup>8</sup>

NAPs focus exclusively on adaptation and, in addition to guiding the implementation of adaptation action across all sectors, provide the basis for the information to be

presented in adcoms under the Paris Agreement and which may be communicated as adaptation components of NDCs.<sup>9</sup> They define medium- and long-term priorities and measures as national approaches to adaptation and building resilience against climate change. These processes facilitate "the systems and capacities needed to make adaptation and resilience building an integral part of a country's development planning, decision-making and budgeting, while ensuring it is ongoing practice rather than a separate ad hoc exercise" (Hammill et al., 2020).

Amid the COVID-19 pandemic, anchoring resilience in countries' development and investment plans has become more urgent than ever. The economic, social and fiscal impacts of COVID-19 have further exacerbated vulnerabilities to disasters and climate shocks. When these do occur, they compound the already devastating impacts of the pandemic. In order to have any chance to meet the Paris goals, there is a growing expectation that countries will consider updating their NDCs and climate action priorities through NAPs in 2020, including through the revision process of NDCs.

In the lead-up to COP26, significant momentum for increased national action evolved through e.g. the UN Climate Action Summit in 2019, the Global Commission on Adaptation's "Year of Action" and the June Momentum in 2020. The CVF's Leaders event on the sidelines of the UN General Assembly called on all nations to submit improved NDCs by 31 December 2020 – a Midnight Climate Survival Deadline. As we round out 2020, the Race to Zero November Dialogues, the Finance in Common Summit and the Climate Adaptation Summit in early 2021 present further milestones to gather leadership and support on investment for resilient, zero carbon recovery that can unlock inclusive, sustainable growth.<sup>10</sup> In this context, the integration of risk finance instruments into countries' resilience and adaptation efforts is increasingly being recognized as an opportunity for enhanced resilience planning and investment.

<sup>7</sup> Mitigation and resilience contributions highlighted by countries in their NDCs are grouped into conditional and unconditional contributions, with conditional contributions being contingent on the receipt of international support (or other conditions). Specifying the costs/resources required for conditional contributions thus specifies countries' international support needs.

<sup>8</sup> Risk financing instruments address the fiscal impacts and economic losses caused by climate impacts and natural hazards (e.g. cyclones, droughts, earthquakes, floods). They support countries to increase their financial resilience to climate impacts and disasters. A variety of instruments fall under roughly three categories: 1) market-based risk transfer products (e.g. climate risk insurance or catastrophe bonds), including sovereign, sub-sovereign and micro-level insurance (businesses, farmers, households, etc.), 2) contingent financing products (e.g. contingent credit lines such as a Development Policy Loan with a Catastrophe Drawdown Option) and 3) budget reserves/reallocations at a national level that can be drawn on when a disaster occurs. Under the InsuResilience Global Partnership, risk financing is often specified as Climate and Disaster Risk Finance and Insurance (CDRFI).

<sup>9</sup> The Paris Agreement requires all countries to prepare, communicate and maintain successive NDCs. NDCs serve the purpose for each country to define their pledges, in terms of targets and contributions to the universal agreement according to their national circumstances and priorities. It is a communication instrument that should be submitted every five years to the UNFCCC Secretariat. NDCs have to include national mitigation targets and actions and could, if Parties so decide, include an adaptation component, which could be used by Parties also to communicate information on national adaptation efforts. The planning of these efforts ideally corresponds to the NAPs.

<sup>10</sup> This text was drafted in late 2020. The events mentioned herein took place in various formats and provided important momentum for global climate action, with a particular focus on finance and adaptation.

Likewise, the process of formulating and implementing NAPs, which several countries are currently undertaking, should be leveraged to integrate risk finance instruments in national and sub-national approaches towards adaptation, disaster risk reduction, and resilience building. The adcom is then a useful tool for communicating these actions and elevating the profile of adaptation. These are opportunities to strengthen and accelerate adaptation and resilience action in support of economic recovery, while addressing the underlying causes which amplify both the unforeseen impacts of sudden climate events and the pandemic, and to thereby reap the triple dividend of resilience investments.

The InsuResilience Global Partnership is a global multi-stakeholder platform with the vision to strengthen the resilience of the poor and vulnerable in the face of climate change. In support of the Paris Agreement, the UN Secretary General Climate Action Plan, and the work under the Global

Commission on Adaptation, the InsuResilience Global Partnership aims to enable a substantial scale-up in the use of risk finance instruments to complement broader resilience and adaptation efforts. Against this backdrop, a writing team was formed between the InsuResilience Secretariat, the CVF-V20 Secretariat, the NDC Partnership Support Unit, MCII, and the UNFCCC to develop this Policy Note. The Note highlights benefits of risk finance strategies and instruments for resilience planning and investment, drawing from an analysis of NDC Partnership member country requests for enhancing and implementing resilience measures. It outlines country needs for integrating risk finance strategies and instruments effectively, and how such integration can incentivize and inform resilience investments beyond risk financing. The Note concludes by suggesting action areas for the InsuResilience Global Partnership to be taken forward in cooperation with other partners and initiatives.

### 3

## The role of adaptation planning for national resilience efforts

Planning for, and investing in, adaptation and efforts to scale up disaster reduction, response and recovery to manage residual risks, thus averting and minimizing loss and damage, are key to achieving the goals of the Paris Agreement and embarking on a climate-resilient development path. Projected climate impacts affect countries or regions in different ways. This requires governments to understand their unique climate vulnerabilities and the cost-effectiveness of implementing specific adaptation measures, when specifying investment targets and formulating the corresponding adaptation financing modalities. These modalities include national budget allocations, strategies to leverage private capital, and increasing international climate finance for adaptation.

A comprehensive climate and disaster risk management approach combines long-term climate adaptation efforts with disaster risk reduction, response and recovery, while engaging a wide array of stakeholders, including government planning bodies, the private sector, civil society and

development agencies to ensure effective and efficient use of knowledge and resources. Its building blocks consist of:

1. Risk Prevention and Reduction
2. Preparedness
3. Financial Protection and Risk Transfer
4. Resilient Recovery (long-term adaptation).

Investment portfolios which integrate those four areas can work to achieve resilience objectives cost-effectively. Setting quantitative and sectoral investment targets for resilience builds, in turn, on adaptation plans and long-term objectives defined herein. Adaptation plans identify, analyse and prioritise adaptation measures using a variety of approaches, such as their cost-effectiveness. This requires prior understanding of the losses associated with the materialization of climate risk and the gains from avoiding or reducing climate risk exposure and the magnitude of impacts. Currently, the risks, the associated financial losses, the measures for addressing these losses, and the cost-effectiveness of such measures are mostly unknown to vulnerable countries.

Risk financing offers several benefits in support of countries' adaptation and investment planning requirements. The following chapters will explain the direct benefits of risk finance, examine the role of risk financing in current NAPs and NDCs, and analyze a subset of adaptation financing needs received by the NDC Partnership.<sup>11</sup> This provides an overview of how better integration of risk financing can support countries in understanding and capitalizing on its benefits, addressing broader gaps in investment planning, and promoting the creation of comprehensive risk finance strategies.

### Main benefits of risk finance for enhancing resilience and adaptation

Risk finance instruments strengthen the financial resilience of countries in the face of climate and disaster risk; saving lives, livelihoods, property and safeguarding development gains and economic growth. The predictability of funding enables governments to plan their budgets more reliably and supports long-term fiscal stability even as catastrophic climate risk increases.

For effective outcomes, a tailor-made country approach for risk finance instruments, combining national contingency funds, the development of national insurance markets, and sovereign risk finance in the form of risk transfer instruments and contingent credit lines, complemented by international support, is key. This helps to effectively address residual risks and improve the cost-effectiveness of insurance instruments. While there are opportunity costs when investing in risk financing, e.g. payments for insurance premiums and contingency budgets, the direct and indirect financial impacts of disasters often exceed the costs of investments that could have been made beforehand to protect economies and people.

### What are main resilience benefits when implementing risk finance instruments and strategies?<sup>12</sup>

#### **Complementing adaptation measures cost-effectively:**

Risk financing covers residual risks that could not be mitigated in a cost-effective manner through other adaptation measures. For example, risk financing can reduce disaster-related contingent liabilities from public assets for high severity but low frequency impacts, where resilience investments into infrastructure are no longer cost-effective.<sup>13</sup>

#### **Easing humanitarian and economic shocks through reliable emergency response:**

Risk finance instruments can provide rapid liquidity for fast emergency aid and reconstruction (e.g. through index-based insurance mechanisms or contingent credit lines). In many cases, payouts can even reach those affected before a crisis unfolds (e.g. for slow-onset events like drought) and can contribute to maintain consumption of basic goods, reduce malnutrition, and keep children in school, even in times of distress. Predictable funding enables countries to plan more reliably for and during disasters, while the immediacy of payouts supports quick economic recovery, for example by repairing infrastructure critical to supply chains.

Rapid funding from risk finance instruments can also help households maintain their assets and their long-term economic viability, with a positive effect on food security, employment, social security, gender equality and tax income. In contrast, delays in post-disaster funding put more lives and livelihoods at risk, prolong business and supply chain interruptions and slow down economic recovery with potentially severe effects for long-term growth and poverty reduction.

11 The NDC Partnership supports countries in achieving their Nationally Determined Contributions and ensures the coordination of financial and technical assistance. In this capacity, the adaptation requests received from member countries of the NDC Partnership can be grouped in three tiers: Adaptation Planning, Investment Planning and Financing instruments. The data of the NDC Partnership is based on adaptation and resilience requests found in 925 implementation needs communicated by 32 countries, and 1083 enhancement needs communicated by 57 countries. Implementation and enhancement datasets are separate and therefore, there are no instances of overlap between these requests.

12 While acknowledging that there are challenges related to the implementation of risk financing instruments, for the purpose of this paper only the resilience benefits are assessed. Challenges to risk financing include affordability issues, pricing out some segment of the population, opportunity costs of investments in risk finance versus other development priorities, maladaptation, or undermining investments in disaster risk reduction.

13 One example of this is Mexico's Fondo de Desastres Naturales (FONDEN). FONDEN is a financial vehicle through which the Federal Government allocates budget ex-ante for post-disaster relief, rehabilitation, and reconstruction of critical public infrastructure. It applies a risk-layered strategy: the bottom layer is financed with FONDEN's annual budget appropriation, for higher risk layers, FONDEN transfers the risks to insurers and to capital markets.

**Demonstrating disaster preparedness through contingency plans:** Some risk finance instruments require the design and implementation of a pre-defined emergency plan.<sup>14</sup> This can encourage countries to adopt a culture of impact-driven, prevention-focused risk management. In combination with pre-arranged, trigger-based disbursements through channels such as shock-responsive social protection programmes, risk finance can help vulnerable households bounce back faster. In addition, demonstrating preparedness, both financially and institutionally, could positively affect the assessment of sovereign credit risk and hence countries' access to international capital.

**Supporting long-term fiscal stability:** Risk finance solutions can sustain a country's sovereign financial management in an environment of increasing climate risk. Insurance payouts, contingency budget lines and other instruments provide funds that are available when needed and can reduce public (contingent) liabilities. Governments avoid reallocating scarce resources within the national budget or borrowing on very poor financing terms directly after a disaster. Consequently, debt levels of vulnerable countries with limited tax revenue are not exacerbated, and funds allocated to adaptation measures or other investments in socio-economic development remain secured. Moreover, government income, including from tax revenue, can be stabilized once support for relief and reconstruction is provided, thereby softening impacts on governments' fiscal space after a disaster.

### How do vulnerable countries currently integrate risk finance strategies and instruments in their NDCs and NAPs? What support has been requested for the revision of NDCs?

An analysis of submitted NDCs and NAPs, as well as the country requests for support currently received by the NDC Partnership,<sup>15</sup> shows that a minority of countries account

for risk financing in their resilience efforts, and that those doing so do not yet capitalize on the gains that could be made from combining different instruments. Within the V20 Group of Ministers of Finance,<sup>16</sup> 28 countries refer to risk financing interventions through either their NDCs or NAPs.<sup>17</sup> Geographically, V20 economies from Africa and the Middle East account for 43 % of V20 economies that mention risk financing in their currently submitted NDCs and/or NAPs, well above their overall representation in the V20 of 35 %.<sup>18</sup>

In contrast, V20 economies from Asia and the Pacific account for 39 % of V20 economies including risk financing in NDCs and/or NAPs, well below their overall representation of 46 % in the V20. Economies from Latin America and the Caribbean (LAC) account for 18 % of V20 economies including risk financing in NDCs and/or NAPs, which corresponds to their V20 membership of 19 %.

The NDC Partnership receives requests for support from its member countries to help implement and revise their existing NDCs and turn them into a roadmap for action.<sup>19</sup> Within the requests received by the NDC Partnership from member countries as part of the NDC implementation and revision process, only 40 % specifically cite a need for climate risk financing. Instruments which emerge most frequently as part of those requests include climate risk insurance (e. g. weather-based insurance system for crop production), national funds (e. g. Agricultural Risk Management Fund), and public-private financial insurance mechanisms. The focus on insurance instruments is also reflected in currently submitted NDCs and NAPs of V20 economies, with only a minority underlining the need to put in place comprehensive risk finance strategies that also consider other types of risk finance instruments beyond insurance.

Only a few countries express needs specifically for building capacity to implement risk finance. For example, one LAC country made a request to prepare for the implementation of risk finance instruments through the development of a

14 A contingency plan is a plan of action to respond to certain potential negative events (contingencies) which could occur and could cause losses. Contingency planning is ultimately about preparing for potential future disruptive unknowns. Contingency plans emerge from thorough risk analyses and assessments to both manage / mitigate that risk and to respond to potential occurrences. As a staple component of climate and disaster risk management, contingency planning can be defined as a management process that analyses disaster risks and establishes procedures in advance to enable timely, effective and appropriate responses to catastrophes. Within sovereign-level disaster risk finance instruments, payouts can be tied to pre-arranged contingency plans to ensure that the disbursed funds are channelled to immediate disaster response measures which provide relief to the targeted beneficiaries. An example is the African Risk Capacity drought insurance offered to African governments that requires pre-defined contingency plans at a national level.

15 The adaptation requests received from member countries can be grouped in three tiers: Adaptation Planning, Investment Planning and Financing instruments. The data of the NDC Partnership is based on 3174 implementation requests from 42 countries, and 1086 enhancement requests from 65 countries. A subset of 31 % of implementation requests and 15 % of enhancement requests focuses on adaptation and resilience and is used for this analysis.

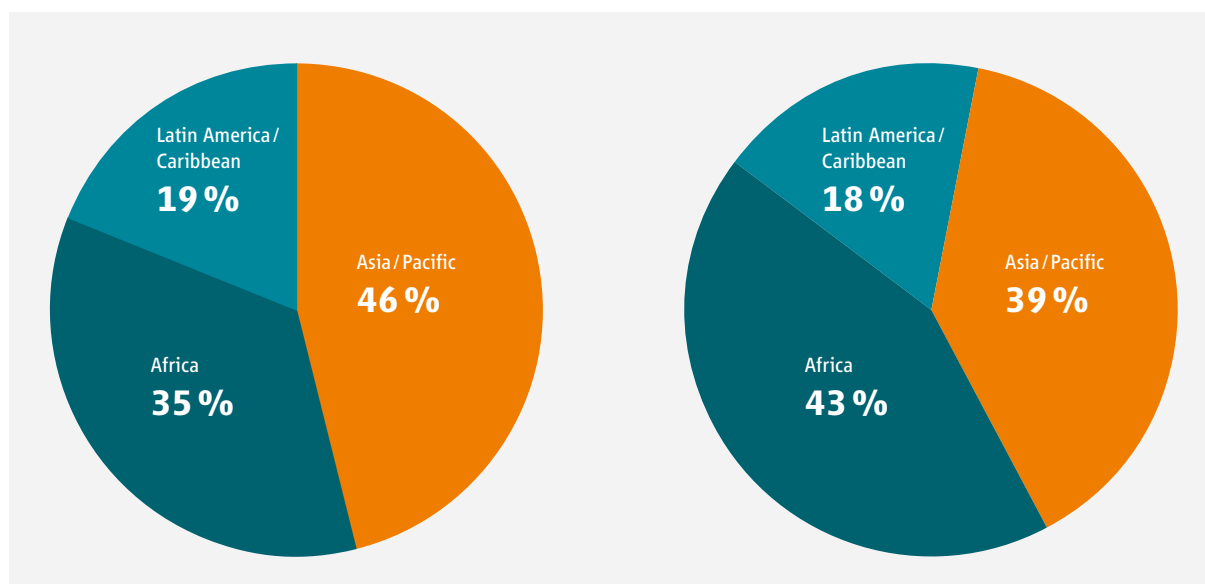
16 Spans a total of 48 countries vulnerable to climate change.

17 NDCs: Bhutan, Dominican Republic, Ethiopia, Fiji, The Gambia, Haiti, Kenya, Kiribati, Malawi, Maldives, Marshall Islands, Mongolia, Morocco, Niger, Papua New Guinea, Philippines, Rwanda, Senegal, Sri Lanka, Tanzania, Timor-Leste, Tunisia, Vietnam. NAPs: Burkina Faso, Colombia, Grenada, Ethiopia, Fiji, Kenya, Kiribati, State of Palestine, St Lucia, Sri Lanka.

18 Out of the 48 V20 economies, 35.4 % (17 countries) are based in Africa, 45.8 % (22 countries) in Asia and the Pacific, and 18.8 % (9 countries) in Latin America and the Caribbean.

19 34 of 48 V20 member economies are also members of the NDC Partnership (70 %).

## V20 Economies by region



training platform and workshops on incorporating climate risk management into projects and programs. Three have requested support for the development of national funds (i.e. for Prevention, Mitigation and/or for Disaster Response), and national budgeting for adaptation (i.e. integrating food security, gender, disaster risk reduction & central, provincial and local resilience into a country's budget processes).

With a view to mobilizing project and program financing and resources, the NDC Partnership finds that in contrast to the many preparatory capacity building requests to mobilize adaptation finance (e. g. unlocking GCF funding), only 17% of countries that express investment planning needs seek support to specifically access or implement multi-sector risk finance instruments.

### What findings can be drawn for country needs?

While 14 countries across the NDC Partnership and V20 acknowledge the relevance of risk finance, there seems to be a lack of awareness of instruments beyond insurance, or the impression that such mechanisms are not the right fit, and hence for devising comprehensive risk finance strategies. Countries may need support not only in strengthening their

## Reference to risk financing in NAPs or NDCs of V20 Economies

capacities to combine different risk finance instruments, but to identify combinations of broader adaptation efforts and risk finance measures (i.e. integrated resilience portfolios), and particularly to assess the cost-effectiveness gains of doing so. This is also supported by the NDC Partnership's findings, which suggest countries face barriers in moving from adaptation planning to implementation and investment due to fragmentation and a lack of interoperability between datasets for prioritizing adaptation measures, and difficulties coordinating across different sectors and harmonizing planning approaches within countries. This in turn can lead to challenges in understanding how to combine different types of investments to reduce overall costs while maximizing resilience outcomes.

Better access to relevant information and decision-making tools could support both: identifying combinations of adaptation, risk reduction and risk finance measures, and quantifying their costs. This could demonstrate, how such measures interact and complement each other to deliver maximum resilience at lowest overall cost. Addressing this gap can also support countries in better understanding how they can integrate their risk finance objectives and needs into their NDCs and/or NAPs, alongside their adaptation goals.

## 4

## Enhancing resilience investments through the integration of risk finance into adaptation planning

The mechanisms underlying the design of risk financing instruments can promote substantial progress providing the necessary information and decision support systems. More specifically, risk pricing, comprehensive risk assessments, and risk layering can set the foundational basis to address underinvestment in resilience and inform investment decisions, as part of developing and implementing NDCs, NAPs and/or adcoms.

**Risk pricing – incentivizing risk-informed planning and resilience investments:** The introduction of risk finance instruments builds on detecting and pricing risk. Insurance policies are concluded on the basis of a systematic risk assessment, whereby the price of insurance depends on the level of risk (“risk pricing”). The recognition stemming from such risk pricing can drastically shift the economics of operating in a system<sup>20</sup> by incentivizing risk-informed planning and adding value to investments in and tools for disaster risk reduction, climate risk management and sustainable development. In such context, the incentive for enhanced investments in adaptation and risk reduction would result in countries reducing high investments in, for example, insurance premiums or other products that can address liquidity needs for disaster response, recovery and reconstruction. This would occur as risk reduction investments will decrease the height of the necessary investment in risk finance instruments. By putting a price tag on risk when considering risk finance as part of national adaptation efforts, governments and the national private sector thus gain access to the information necessary to incentivize and inform the development of economic policies and strategies that shift public and private resources towards more climate-resilient investments. This can support existing country needs. As the requests received by the NDC Partnership show, 46 % of countries expressing investment planning needs request support for developing strategies, plans and mechanisms to improve mobilization of financial flows for the implementation of adaptation in NDCs.

Further, 38 % of countries request support for integrating and aligning adaptation measures into national planning, budgets and revenue streams.

**Comprehensive risk assessments – building resilience baselines:** In order to adequately plan, price, and prioritize investments in adaptation, risk reduction and risk finance, countries need to understand their starting point: their resilience baseline. In addition, the respective effectiveness of such investments in terms of enhancing resilience needs to be fully understood. A resilience baseline could aim to demonstrate how sensitivity to climatic variations under different future scenarios will develop over time, given ‘certain’ conditions.<sup>21</sup> These conditions encompass current adaptation efforts and the dynamic development of those socio-economic conditions that drive vulnerability, risk and adaptive capacity. Building on such an assessment, countries can then move to identify and select resilience measures that help to deviate from the original baseline scenario and strengthen resilience.

The vast majority (95 %) of countries requesting support from the NDC Partnership ask for planning support, most of which need support to assess adaptation challenges and climate vulnerabilities, develop climate modeling and scenarios, and improve the accessibility of data. All of these tools feed into the development of risk finance approaches, as systematic risk assessments are a prerequisite when considering the use of risk finance and identifying the most feasible instruments. Ideally, these assessments deliver localized baselines, account for the interaction of slow- and sudden-onset events, estimate the expected impacts on poverty alleviation, including livelihoods, settlements and human health, and aggregate the associated impacts by sector, e. g. in the form of estimated economic costs.

<sup>20</sup> Refers to the investment context shaped by the political economy of a particular sector in a particular country, defined by valuation methodologies, benchmarks, and access to public and private finance.

<sup>21</sup> The IPCC has conducted sensitivity analyses for global warming extending from a low of 1.5 degrees Celsius to a high of 4.5 degree Celsius.



Currently, there is no standardized methodology for developing resilience baselines and countries rely heavily on technical assistance support from institutional partners. Relevant expertise and information, particularly data and models for adequately pricing and quantifying the economic costs of impacts, remain siloed in the insurance industry. Introducing risk finance as part of their NDCs or NAPs thus represents an opportunity for vulnerable country economies not only to catalyze risk assessments but work with insurance providers to access the relevant data, models, and specifically the methodology they are built on.

**Risk layering and economic modelling – setting investment targets for resilience:** Having understood the projected climate sensitivities across their economies and societies, countries need to understand how much of that exposure can be averted, through which measures, at what price, and which measures combine most cost-effectively given the policy objective to be achieved. 64% of countries making adaptation requests to the NDC Partnership require support to prioritize areas for adaptation intervention, develop actionable planning measures, and build capacities within planning entities. Countries consider cost-benefit analyses to hold a key role in this process, as they help policymakers identify and prioritize adaptation action areas. The mechanisms underlying the development of risk finance instruments include economic modelling approaches that help to identify cost-effective adaptation and risk reduction options and their trade-offs up to a point at which they become prohibitively expensive and risk financing proves more feasible.<sup>22</sup> On that basis, risk finance instruments can then be identified and combined following a risk layering approach<sup>23</sup>.

This would ultimately lead to a menu of options and allow the identification of those combinations of risk reduction and risk transfer investments that comes with the lowest overall costs while maximizing resilience through adequate investment in adaptation, risk reduction and financial protection. Building on such outputs, countries can formulate sectoral investment targets for both adaptation, risk reduction and risk finance measures.

## What findings can be drawn for country needs?

Integrating the development of risk finance instruments into NDCs or NAPs can help countries in deciding among risk reduction and risk finance measures and setting long-term investment targets. The lack of access to recognized and standardized methodologies and decision-making tools, as well as limited country capacities for their application, represent a persistent barrier. Yet, countries can reap extensive resilience benefits by capitalizing on the integration of risk finance instruments and strategies into national adaptation planning, provided the following is also facilitated in line with the needs that countries expressed:

- › **Access to methodologies and tools supporting adaptation planning, monitoring, evaluation and learning:** Investment planning and the development of investment portfolios for adaptation is only possible once national adaptation planning has taken place. Planning requires sound decision making under (deep) uncertainty. Therefore, methodologies and tools are needed that support these processes, e.g. comprehensive risk assessments to set resilience baselines. Subsequently, countries can develop investment strategies and plans that build in a cost-effective mix of resilient investments in risk reduction, retention and transfer, suitable for the policy objective. Furthermore, the economic and financial significance of climate information services is growing, requiring enhanced action and cooperation on collecting the relevant data and making it accessible to vulnerable countries.
- › **Access to mechanisms/methodologies to support resilience investment planning and developing the capacities for applying such mechanisms/methodologies.** This includes the access to, and application of tools related to risk pricing, the Economics of Climate Adaptation (ECA) approach, and risk layering. Building on these tools, countries can identify cost-effective investment options and comprehensive risk finance strategies, set sectoral investment targets, plan budgetary allocations and international support requests, as well as develop frameworks and incentives, which shift public and private financial flows towards resilience.

22 See, for example, the Economics of Climate Adaptation (ECA) approach in [https://collections.unu.edu/eserv/UNU:6181/Guidebook\\_Economics-of-Climate-Adaptation\\_EN\\_002\\_.pdf](https://collections.unu.edu/eserv/UNU:6181/Guidebook_Economics-of-Climate-Adaptation_EN_002_.pdf), analyzing (1) potential climate-related damages over the coming decades, (2) the extent to which such damage can be averted, including through what type of adaptation measures, (3) the investments required, and the costs and benefits (averted loss) they come with, and (4) the residual risk to be covered by risk finance instruments.

23 See, for example, <https://www.adb.org/sites/default/files/publication/615171/disaster-risk-financing-country-diagnostics-toolkit.pdf>: "A risk-layered approach helps identify the optimal bundle of disaster risk finance instruments. Such an approach breaks disaster risk down according to the frequency or probability of occurrence of hazard events and associated levels of loss for each layer of risk to identify the most cost-effective instruments for each layer."

## 5

## Action Areas for the InsuResilience Global Partnership

The analysis above underlines major benefits of integrating risk finance considerations into national adaptation and resilience efforts, addressing genuine needs expressed by countries in the context of the NDCs and NAPs and which are expected to become more relevant in the wake of COVID-19. Almost all V20 economies make substantial reference to resilience in their NDCs, with many V20 economies viewing NDCs as their new long-term development strategy and investment plan and as a significant opportunity to strengthen and accelerate adaptation action. The InsuResilience Global Partnership, as a V20/G20 led partnership which brings together the world's leading disaster risk finance programs, is uniquely positioned to scale up and coordinate efforts to integrate risk finance instruments and strategies into adaptation planning at the national level, and support countries in reaping their full benefits. Building on the analysis above, the InsuResilience Global Partnership may help to fill the remaining gaps in baseline data, menu of adaptation, risk reduction and risk finance options, including their cost-effectiveness and the related trade-offs, and promoting international support and the shift of financial flows towards resilience, by driving action along the following areas:

1. **Raise awareness and support advocacy for the benefits of integrating risk finance instruments and strategies into national resilience and adaptation efforts:** Throughout all its available communication and advocacy channels, the InsuResilience Global Partnership may expand the information on these benefits and corresponding opportunities for vulnerable countries, highlighting the importance of raising international support to developing countries for implementing adaptation and risk reduction measures. To inform such endeavours, the specific constraints and obstacles in uptake of risk finance instruments on a national level, and ways to overcome these, may be analysed and disseminated. Together with the NDC Partnership, the NAP Technical Working Group and other initiatives, the InsuResilience Global Partnership may also increase countries' awareness around considering resilience planning and risk financing in their national adaptation. These initiatives may promote exchange between Ministries of Finance, planning departments, and other ministries, and inform about methodologies and tools that have been successfully implemented.





- 2. Enhance capacity building across in-country institutions:** In collaboration with the NAP Technical Working Group and the NDC Partnership, and as a response to country requests, the InsuResilience Global Partnership may scale up capacity building efforts to support countries integrating risk finance considerations early on in adaptation planning and strategies, in addition to selecting and deploying risk financing mechanisms, with a view towards enhanced resilience.
- 3. Strengthen availability and access to data, information and knowledge to model resilience baselines, deal with uncertainty, and set investment targets based on outcomes:** Leveraging the operational resources of implementing partners, the InsuResilience Global Partnership may strengthen efforts to develop and make accessible recognized and robust methodologies and tools for vulnerable countries to establish a resilience baseline against which to set investment targets and plan adaptation, risk reduction and risk financing measures cost-effectively. Such efforts may also support South-South exchange work with the South-South Center on Climate Information Systems of the Climate Vulnerable Forum (CVF) to ensure needs-responsive tool design when increasing the availability of climate information services relevant for financial and economic decision-making. The NDC Partnership and the NAP Technical Working Group can support in awareness raising and dissemination of such tools and methodologies.
- 4. Promote country-driven access to private sector expertise and capital:** The InsuResilience Global Partnership may explore and concretize avenues through which countries can systematically and freely access and independently utilize expertise of the risk industry early on in planning and pricing adaptation, including through building local insurance capacities in vulnerable countries. Building on that, it may also promote an engagement of the industry's risk capital to help fill gaps on financing for adaptation investments, if and where cost-effective. Through its country engagement process, the NDC Partnership could match requests with products/actors that are available.
- 5. Disseminate good practices:** The InsuResilience Global Partnership may identify and disseminate good practices for countries with a focus on South-South exchange on expertise and innovative solutions in finance, technology and policy, e.g. in cooperation with the CVF's South-South Center. Practices can be shared on how to better integrate risk finance strategies and instruments in their NAPs, and on how to communicate information on those strategies and instruments in their revised NDCs or adcoms. The NDC Partnership can supplement this work by identifying tools and existing good practices from their member countries that can be showcased through knowledge products, e.g. online trainings, blog posts, and briefings.

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