



Policy Note

Smart Premium and Capital Support

Enhancing Climate and Disaster Risk Finance Effectiveness Through Greater Affordability and Sustainability

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Preamble

Climate and disaster risk finance and insurance (CDRFI) promises substantial resilience benefits. Yet, due to affordability challenges as well as market inefficiencies, to date they are not used to the extent they could. Limited uptake, in turn, threatens the sustainability of their supply. In the wake of fiscal pressures that were exacerbated by the Covid-19 pandemic, the topic of premium financing as a means to financially support CDRFI solutions and address the affordability challenge is gaining importance.

In this context, the effectiveness of financial support for CDRFI could be improved by a coordinated, principled approach to premium financing. For this, there is a need to overcome **the lack of awareness and evidence-based guidance on the conditions under which affordability and sustainability concerns for insurance solutions in vulnerable countries are best addressed** through – inter alia – premium financing or other forms of concessional finance.

Against this backdrop, the IGP aims to arrive at a joint understanding on how to maximise the effectiveness of premium and capital support for insurance as one important element of comprehensive climate and disaster risk financing strategies. IGP initiated a collaborative process among members (see [List of consulted entities](#)) through a series of expert consultations, including at the 4th meeting of the InsuResilience High Level Consultative Group (HLCG) in June 2021. The HLCG mandated the InsuResilience Secretariat to develop a normative Policy Note on Smart Premium and Capital Support centered around a set of principles. **The HLCG approved the principles at its 5th meeting on the 27th of October 2021.**

The **SMART Principles further respond to the G7 Foreign and Development Ministers' agreement under UK's G7 presidency** to “improve the impact of [CDRFI funding commitments made at the G7 Summit in July 2021] by establishing best practice principles by COP 26 in co-ordination with the InsuResilience Global Partnership” ([UK FCDO 2021](#)).

The Policy Note aims to present a common understanding among InsuResilience members and partners regarding recipient eligibility, volume, duration, and form of premium and capital support as well as the conditions under which this support will be provided. The SMART Premium and Capital Support Principles presented in Part A provide an overarching framework to address these questions. They offer conceptual guidance for the provision, channelling and use of PCS by donors, implementers, clients and other recipients, and are intended to inspire a **principled, coordinated approach on PCS provision and use among stakeholders**. Part B presents an overview on how the principles could be applied in programming and designing premium and capital support at the macro- and meso-/micro-levels.



A

Part A: Principles for SMART Premium and Capital Support

I. The need for Premium and Capital Support

Protecting the lives and livelihoods of poor and vulnerable people from the impacts of disasters is more urgent today than ever. Climate-related disasters have increased significantly in frequency and severity, and climate change is expected to further exacerbate losses, especially in developing countries (WRI 2019). Yet, in many countries, including high-income ones, disaster response systems often struggle to react quickly and help those in need. Political and other interests may not be aligned with preventing the worst outcomes of disasters, which can result in sub-optimal decisions being taken and response activities being delayed (Lung 2020).

Evidence is growing¹ that **ex-ante planning for early action, relief and recovery, in combination with prearranged financing to carry out these plans, are crucial to assist affected communities faster and**

more effectively and to lower the overall cost of disasters. Nonetheless, the current system of international development assistance in many ways still favors ex-post disaster finance over ex-ante finance for resilience building and disaster preparedness. For example, ex-post finance for disaster recovery and reconstruction is often available on more concessional terms than finance to prepare for disasters (Clarke and Dercon 2019).

The IGP has set out to accelerate a shift from ex-post financing to prearranged risk finance. The InsuResilience Vision 2025 aims to scale up Climate and Disaster Risk Finance and Insurance (CDRFI) solutions to 500 million poor and vulnerable people by 2025, in line with **established best practices** (see [Annex](#)). CDRFI instruments empower countries and individuals as proactive risk managers and lend assistance in managing residual risks. Risk reduction

¹ See for example Cabot Venton et al. (2012), Clarke and Hill (2012), Hill et al. (2019), World Food Programme (2019), Lung (2020).

is critical to ensure that CDRFI is cost-effective. Therefore, it is widely recognised that CDRFI is most effective when integrated in comprehensive risk management and adaptation planning and when different CDRFI instruments are applied to the various layers of risk, depending on the financial cost of each instrument (WRI 2019).

Yet, affordability of CDRFI solutions, in combination with other factors (see footnote 3), often limits their uptake. This has been exacerbated by severe fiscal and economic pressures in poor and vulnerable countries as a consequence of the **Covid-19 pandemic**. Limited uptake of solutions, in turn, **threatens the sustainability of their supply at affordable prices**. This is true for solutions offered to (sub-)sovereigns, such as insurance by regional risk pools, as well as for meso- and micro-level market-based solutions in vulnerable countries. Without widespread uptake of their products, risk carriers lack diversification and economies of scale, driving up the cost of capital and operations. Higher premiums, in turn, further constrain the ability of vulnerable countries and people to take out the policies on offer.

Scaling up concessional financial support² for ex-ante risk financing has the potential to break this cycle. It can improve affordability and uptake, strengthen risk carrier sustainability, and ultimately increase resilience benefits for vulnerable countries and people. Two of the main instruments to improve the affordability and sustainability of insurance solutions specifically are **premium financing³** and the **capitalisation of risk carriers⁴** (Premium and Capital Support (PCS)). To date, both approaches have been widely used, though in a suboptimally coordinated manner: When considering support to CDRFI programmes, donors are often tempted to provide finance to insurance vehicles to increase their capital base, rather than providing premium subsidies—even when “like for like” premium subsidies would deliver more benefits. All too often, this supply-side fix to demand-side problems does make poor use of scarce donor finance. In other contexts, however, particularly when supporting micro-

and meso-insurance solutions or establishing and building new macro-level risk transfer institutions, capital support may be well-justified.

The scope of this Policy Note is limited by the following considerations. Firstly, while a lack of affordability is one of the main barriers to greater CDRFI uptake, it is certainly not the only one.⁵ Among a range of various forms of concessional support for CDRFI that have different merits and caveats in addressing different barriers (see e.g. InsuResilience Secretariat (2019) for a detailed discussion), **the discussion here is limited to premium and capital support. This is because these are among the most widely used tools and among those most explicitly focused on the affordability concerns raised by poor and vulnerable countries.** Still, it is of paramount importance to consider support tools to improve affordability of insurance in conjunction with concessional finance for other disaster risk finance instruments. In order to optimise impact and address the most relevant barriers in the most effective way, the selection and provision of PCS and other support forms should be based on **rigorous analysis and identification of these barriers**. Relatedly, support initiatives should be clear on the precise objectives they are pursuing in trying to overcome these barriers. This Policy Note operates on the assumption that greater risk carrier sustainability will be a second-order effect of enhanced affordability and greater uptake of their products. The term risk carrier is used throughout this note to refer to both macro-level (e.g. risk pools) and meso-/micro-level insurance vehicles that could be supported by donors with both capital and premium financing. Where financial sustainability of risk carriers is more narrowly defined (e.g. as risk carriers being fully independent of donor assistance, see Vivid Economics et al. (2016) for an in-depth discussion) and taken into view as a first-order support objective, implications for PCS design may differ.

2 For the purpose of this Policy Note, concessional financial support refers to financial support provided at any level of concessionality, i.e. via grants or through concessional debt instruments, such as loans. The concessionality level is a measure of the “softness” reflecting the benefit to the borrower compared to a loan at market rate (OECD 2011). See also [InsuResilience Secretariat \(2019\)](#) for a list of concessional CDRFI support tools.

3 Direct grants or potentially concessional loans to countries for a portion of insurance premiums. Premium support directly lowers the premium payable for the policyholder while keeping risk carrier receipts unchanged.

4 The provision of concessional capital (such as through grants, loans, or equity) to capitalise insurance vehicles reduces capital costs of risk carriers. In the first place, capital support provided through donor funds can serve to uphold solvency requirements related to the risks underwritten by the risk carrier. Any excess capital beyond these requirements can further be used for investments into operational improvements, market expansion, development of new products, and other enhancements of the supported risk carrier, but other forms of support (such as targeted technical assistance) can similarly target such endeavours. Via the reduction of capital cost, capital support also may lead to lower premiums for policyholders. In this sense, both instruments can enhance affordability and improve CDRFI uptake. While capital support is by definition provided to the risk carrier (and thus benefitting the insured indirectly), premium support could in principle be provided to either the risk carrier or the insured.

5 Beyond affordability, a lack of understanding, trust and value recognition among potential clients as well as supply-side issues including suboptimal market regulation were most commonly mentioned in the consultations informing this Policy Note. Also, concessional offering and (uncoordinated) advice from other development partners sometimes makes the case for CDRFI solutions not clear-cut.



II. Next Steps for Premium and Capital Support

The Principles for SMART Premium and Capital Support contained in this Policy Note set the stage for scaled-up action on enhancing CDRFI affordability and sustainability on the ground. They offer **conceptual guidance for the provision, channelling and use of PCS by donors, implementers and recipients**. Presenting common ground among the diverse members of the IGP, the Principles depict the variety of perspectives and contexts that constitute the richness of the Partnership. They align with related major international initiatives and processes, such as the V20's Climate Vulnerable's Finance Summit [Communiqué](#) call "to close the 98% financial protection gap against climate and disaster risks through the systematic provision of smart premium subsidies and capitalisation support",⁶ the V20 Climate Prosperity Recovery Agenda on addressing macro-financial risks in relation to climate change (see Volz and Ahmed 2020; V20 Group 2020), as well as the increased focus on Effective Disaster Risk Financing during the UK's G7 Presidency in 2021 and with a view to Germany's G7 Presidency in 2022. **Against this backdrop, the Principles are intended to drive a significant scale-up of affordable and sustainable CDRFI coverage effectively in place through the principled provision of PCS.** By ensuring greater affordability and sustainability of prearranged risk financing solutions, SMART PCS ought to be a catalyst for the urgent global shift from ex-post disaster finance to ex-ante risk financing.

More specifically, the SMART PCS Principles should inspire action on the ground and inform the design of new and existing programmes. Given the principles' grounding in the G7 Foreign and Development Ministers' mandate, these include, but are not limited to, PCS programmes financed from CDRFI funding commitments made at the occasion of the G7 Summit in July 2021. **Relevant programmes, PCS schemes, and IGP members that may contribute to SMART PCS provision include, but are not limited to:**

- › the continuation and next phase of the Global Risk Financing Facility;
 - › individual premium support programmes for the regional risk pools, such as the existing ADRIFI programme, the planned establishment of the new ARC Premium Support Facility, and the planned premium support programme for PCRAFI as well as any potential future capital injections by donors;
 - › the provision of premium subsidies to meso- and micro-level risk transfer programmes under the InsuResilience Investment Fund (IIF) Premium Support Facility and the InsuResilience Solutions Fund;
 - › other programmes as deemed feasible and relevant.
- Against this backdrop, the V20 demand that new and existing programmes for scaling up PCS should be based on three specific criteria (V20 Group 2021b, p. 5).⁷

⁶ The structure of the SMART Principles below builds on consultations with the V20 Troika (V20 Group 2021a) as well as the MCII Background Note on PCS (Panda et al. 2021a and 2021b), capturing and expanding on key priorities of the V20 Group (see also V20 Group 2021b).

⁷ 1) operational efficiency; 2) the individual political economy contexts of target countries and markets; and 3) acceptance and credibility towards donor and recipient countries as well as international finance institutions, such as development banks.



While the Policy Note at hand contains conceptual guidance for these programmes and other stakeholders on the application of the SMART Principles at both a macro- and meso-/micro-level (part B), it should be noted that **the PCS decision-making frameworks should be subject to further evolution over the coming years.**

In some instances, **technical follow-up work is warranted to specify suitable methodologies for criteria proposed here**, in particular for metrics/thresholds for poverty and vulnerability/risk, the calibration of a PCS relative performance score, the weighting of Value for Money (VfM) model factors, and for setting appropriate amounts of PCS to be provided. Generally speaking, however, these methods should be simple, entry barriers low, and allocation rules straightforward.

This is partly because currently there is not enough evidence and even less experience with what the “right” criteria and methods are to translate the principles into practice, i.e. those that will promote a sustained increase in high-quality pre-arranged CDRFI over time. The initial phase (3–5 years) of principled PCS provision will provide lessons on what works and inform how the framework should evolve in future years. **An inclusive framework for PCS provision under the IGP should accompany this evolution**, set timeframes for when criteria will be reviewed, and determine performance indicators that pre-determine whether the criteria need to be adjusted at those review points. This learning framework should also outline how recipients can meaningfully be part of conversations around how the scheme will be implemented and evolve.

This should be complemented by dedicated research, including, but not limited to, the optimality conditions for PCS in comparison to other CDRFI- and non-CDRFI support tools. **Research in this area will be undertaken as part of the InsuResilience Evidence Roadmap.**⁸ Based on the above considerations and the Evidence Roadmap, in 2021–22 the IGP will develop a dedicated research and learning plan for the SMART PCS decision-making framework (see [Part B, Section II](#) for more detail).

⁸ One of the Evidence Roadmap’s evidence priorities, for instance, reads as follows: What is the value for money of implementing CDRFI in specific contexts, compared to other ways of funding disaster response? Are subsidies for CDRFI good use of public resources in a given context, and how is this determined?

The SMART Premium and Capital Support Principles

The SMART Premium and Capital Support Principles aim to provide evidence-based guidance on the conditions under which affordability and sustainability concerns for insurance solutions by vulnerable countries and people are best addressed through premium financing or capital support. In order to strengthen affordability and sustainability of risk transfer mechanisms and ultimately improve protection of the poor and vulnerable from disasters, PCS should be provided and used in a manner that ensures:

Sustainable Impact for the Most Vulnerable

To enable tangible, lasting change in the lives of those most vulnerable to disasters, PCS should be used to fund risk transfer mechanisms coupled with effective, development-oriented delivery systems. Smart PCS entails a clear dedication to reach the poor and vulnerable, including through supporting real impact in line with the InsuResilience Pro-Poor Principles.

S

Sustainable
Impact for the
Most Vulnerable

M

Value for Money

Value for Money

To maximise poor and vulnerable countries' and people's resilience for each dollar of premium or capital support, PCS initiatives should support needs-based CDRFI products that add value, and entail a clear assessment framework that makes improvements in resilience verifiable and comparable. Smart PCS proactively and effectively crowds-in private capital rather than undermining private sector potentials, recognizing the key role that effective private insurance markets can play in resilience-building of developing economies.

Accessibility

To realise the resilience benefits CDRFI instruments promise, PCS should make risk transfer instruments accessible at a price that is affordable to those who stand to benefit from them, including poor countries and individuals. Smart PCS is needs-based, (climate) risk-adjusted, and aligned with appropriate measures for enabling access, while empowering beneficiaries and promoting client ownership of the solutions employed.

A

Accessibility

Resilience-Building Incentives

To build financial, physical and social resilience, only risks that are too costly to further reduce should be absorbed by risk financing instruments, and only risks stemming from low-frequency and high-severity events should be transferred via insurance. Reducing premiums through PCS should not alter this but keep incentives to reduce risks in place. Smart PCS does not disguise the true risk cost, but allows price signals to guide risk behaviour. To avoid maladaptation and moral hazard, PCS should be performance-oriented, avoid rent-seeking behaviour and undue private market rents.

R

Resilience-Building
Incentives

Transparency & Consistency

To empower recipients and maximise synergies, PCS should be provided and employed in a manner that promotes transparency and accountability towards recipients and at-risk communities as well as consistency and coordination among support offers and providers. Smart PCS is used to finance money-out systems that transparently serve a development purpose. Reliability of support is needed for PCS to unfold its impact, and public monitoring and evaluation (M&E) should be part of all PCS initiatives.

T

Transparency &
Consistency

Figure 1

Applying the SMART Premium and Capital Support Principles at a Macro- and Micro-/Meso-Level





B

Part B: Putting the Principles to Action

Providing detailed information on the content in figure 1 above, Part B lays out how the SMART Principles can be employed in programming and employing PCS at both a macro- and a meso-/micro-level, in Part B.I and Part B.II respectively. **Each section provides guidance on who (which countries and/or micro-level actors) could receive how much premium or capital support, when,**

for how long, and under what (concessional) conditions. Since the principles provide different angles to answering these interrelated questions, each principle is applied to the ones most relevant to them. In turn, some questions are answered by applying multiple principles at once. Such interrelations are pointed out below.

I. Applying the SMART Principles at a Macro-Level

Macro-level CDRFI refers to financial arrangements on sovereign or sub-sovereign levels supporting governments in addressing early disaster response and reconstruction needs. This includes macro insurance schemes such as policies offered to countries (or humanitarian and civil society actors operating in specific countries, e. g. through ARC Replica) by regional risk pools (such as the Caribbean Catastrophe Risk Insurance Facility, the Pacific Catastrophe Risk Insurance Facility, and the African Risk Capacity (ARC)), direct insurance arrangements with the private sector, and capital market-based risk transfer, e. g. catastrophe bonds.

S Sustainable impact for the most vulnerable

Who (which countries) should receive capital or premium support?

For tangible **impact** to unfold in the lives of those that are poor and vulnerable to disasters, premium or capital support should be provided to countries or insurance vehicles that explicitly or implicitly target those countries with

(1) poor

and

(2) (climate) vulnerable and at-risk populations.

Inspired by existing best practice such as the Global Risk Financing Facility's (GRiF) portfolio resource allocation criterion A.1 (Level of economic development and vulnerability) as well as guidance by Panda et al. (2021b and 2021c), **PCS programmes should define exact metrics, thresholds and prioritisation methods for (1) and (2)**. As far as possible, these should be consistent across programmes, and in all cases must be transparently communicated (see [Principle T](#)). In defining these, follow-up work and the PCS learning plan (see [section V](#)) should take the following considerations into account:

- › **Poverty**:⁹ The MCII Background Note in support of V20 perspectives (Panda et al. 2021b) suggests that PCS should be provided to sovereigns with **weak fiscal positions**. In line with this, ARC (2021) suggests GDP per capita as a measure of "financial need" for premium support. Similarly, GRiF criterion A.1 gives priority to IDA countries over IBRD countries.¹⁰ IDA eligibility could hence serve as a proxy for severely restricted ability to pay premiums.¹¹ However, depending on overall PCS availability further prioritisation might be necessary.¹² In such situations, low-income countries (LICs) as a subset of IDA countries could be further prioritised. IDA-eligible countries are moreover included in the World Bank-IMF Bank Debt Sustainability Framework for Low-Income Countries (LIC-DSF) list, and the DSF assessment results could provide more granular insights into countries' ability to pay (ATP).¹³ For non-IDA countries that might warrant PCS in line with the SMART Principles (see [footnote 10](#)), debt sustainability analyses as conducted under the MAC-DSA list (Market Access Countries) might be employed for this purpose. In line with the above and with guidance by the V20 Group (2021b), Panda et al. (2021c) suggest specific indicators for countries' economic and debt status (EDS) that could be employed for (1).

- › **Climate risk and vulnerability**: GRiF criterion A.1 gives priority to "higher risk" countries. Similarly, Panda et al. (2021b) suggest that "special consideration should be given to countries with high climate risk exposure" (p. 9). Others suggest that this risk view should be multi-hazard and extend beyond climate-related risks to also include other types of (natural) hazards. **Country eligibility (and levels of PCS provided) should be (climate) risk-adjusted**, with higher risks translating to the recognition of higher support needs (see also [Principle A](#)) – all while incentivizing, and if necessary supporting, complementary risk management measures and avoiding maladaptation (see [Principle R](#)). ARC (2021), for instance, suggests specific risk metrics of regional relevance as premium support allocation criteria. Such metrics should take account of information on both physical and social vulnerability (see the discussion of "Population and Geography" by Panda et al. (2021c). As suggested by guidance from the V20 (V20 Group 2021a), relevant information of different types could be used for PCS programming by drawing on existing or new country-averaged climate risk indices.¹⁴

9 In contrast to multidimensional poverty definitions that are rightfully used for the Pro-poor principles and in other contexts, the understanding of poverty here focuses on the deprivation of economic income.

10 For IDA eligibility, a country's relative poverty defined as GNI per capita must be below an established threshold (USD 1,185 in FY2021).

11 At the sovereign level, some experts suggest that CDRFI (un)affordability is best discussed as determined by ability and willingness to pay (ATP and WTP, respectively) insurance premiums, as a government decision to take out insurance or not "is foremost a question of political priorities" between the alternative range of possible expenditure items, the flexibility to increase taxes or to run budget deficits (Vivid Economics et al. 2016, p. xi). Others, however, discourage the use of these variables as programming criteria for their lack of empirical observability.

12 On the other hand, in line with the GRiF criteria, situations might arise in which PCS for non-IDA countries (i.e. IBRD countries) might be justified.

13 The joint IMF-World Bank LIC-DSF is a methodology for conducting standardised debt sustainability analysis. The objective of the DSF is to minimise the risk that LICs experience debt distress. For this, the framework helps determine the risks of debt distress, taking account of a country's capacity to carry debt and its projected debt burden under both baseline projections and shock scenarios (see [IMF 2018](#) for more detail).

14 Examples include the CVF Climate Vulnerability Monitor (to be updated in 2022), the Global Climate Risk Index, the Verisk Climate Change Vulnerability Index, the ND-GAIN or the INFORM RISK index.

For how long should premium and capital support be provided?

For sustainable impact, PCS should be provided with a clear strategy of how market-based premiums will be covered in the medium term (see GRiF criterion B.1 “Sustainability and Exit Strategy”).

For a first category of countries, such a strategy will need to take into account that long-term support is likely to be required. This group of countries may comprise countries in fiscal distress (see e.g. Volz and Ahmed 2020) or belonging to a very low-income segment. In exceptional cases, where countries’ ability to pay premiums does not improve significantly even after multi-year support, PCS may be considered for as long as climate-fueled impacts accelerate and it generates substantive quantified resilience benefits¹⁵. This will require periodic comparisons of cost-effectiveness of resilience benefits of the supported CDRFI instruments with other risk reduction or adaptation measures, making sure that the funds used for the PCS are optimally allocated.

For a second category of countries, such a strategy may consist in a plan outlining who will pay future premiums and how sufficient budget resources and government income could be generated and earmarked.¹⁶ This second category of “potential self-purchasers” could consist in (lower) middle income countries that are potential future self-purchasing clients and that, through transitionally lowered premiums, can better assess and learn about the cost-effectiveness and value of sovereign insurance, allowing for a subsequent phase-out of the subsidies. Increased value recognition of sovereign risk transfer solutions should be among the determining factors for potential PCS phase-out schedules for this group of countries.

Where capital support to macro-level risk carriers is deemed appropriate (see the following question), **repayable capital forms should be the default mode**, in order to promote prudence in capital management and underwriting. Where viable, capital should moreover be provided in the form of equity rather than debt (thus attaching **no fixed repayment date**), as this strengthens the risk carrier’s solvency position under current regulatory frameworks. In considering capital support for macro-level risk carriers, attention should be given not to crowd-out existing private sector carriers active in the relevant market(s), so as to avoid creating damaging market distortions.

Where premium support is deemed appropriate, it should wherever possible be provided on a multi-year basis. Since financial planning timeframes of recipient countries often have terms of 3–5 years, **multi-year (3y+) commitments should be the default** in order to promote longer-term certainty. After this initial support period, PCS needs and effectiveness should be re-evaluated in regular intervals, which can be of adequate length, varying from single- to multi-year periods. Especially for low income and lower middle income countries, the time needed to stabilise the country’s fiscal position (and, implicitly ability to pay) should be among the guiding criteria determining the PCS phase-out schedule (if any) (Panda et al. 2021b). This is particularly true and needed for more countries than before in the aftermath of Covid-19. To support a gradual phase-out over the foreseen multi-year period, premium financing could be combined with further support for countries with a view to generating additional public revenue, particularly through national mitigation or resilience investments in line with an integrated climate and resilience-building strategy. The duration of premium support should moreover be considered jointly with the adjustable size of support (see [Principle M](#)).

¹⁵ Long term PCS provision will be based on clearly defined criteria, time-bound subsidization strategies and in alignment with broader development finance packages.

¹⁶ In the development of such plans, factors such as the treatment of premium payments as “atypical” payments, relevant public finance legislation, or uncertainty arising from incomplete or unfavourable legal and institutional frameworks regulating sovereign insurance must be closely regarded (World Bank 2017).

What form of support – capital or premium support – should be provided?

In many cases, premium support is likely to be more effective than other interventions at addressing demand-side issues such as fiscal constraints. One of the main merits of premium support is that unlike capital support it can be specifically targeted to the poorest countries. In cases in which the political objective is collaboration on enhancing the resilience of individual, low-income climate vulnerable countries, premium support is likely to be superior and should be given due consideration in comparative analysis (see [Principle M](#)). Supply side measures such as capital support (either as initial capital when setting up a new risk pool or as capital raise for existing risk pools), by contrast, typically support the entire risk pool, implying that premium levels might be reduced for countries “who do not necessarily require it” (Vivid Economics et al. 2016 p.52). As a consequence, where benefits for all risk pool members are being sought, capital support should be given due consideration. Capital support is particularly relevant for new risk pools (especially those that are set up cooperatively), as it greatly facilitates institution-building. For sufficiently capitalised existing risk pools, capital raises often do not provide significant value-added over alternatives (such as re-insurance capacity), and specifically when compared to premium subsidies (see [Principle M](#)).

M Value for Money

How much premium or capital support should be provided [to project X]? At what level of concessionality?

Promoting truly integrated risk management (see Principles A and R), a comparison of the cost-effectiveness of resilience benefits and costs of CDRFI instruments with other risk reduction or adaptation measures (such as via the Economics of Climate Adaptation method, see UNU-EHS 2021) **should precede the provision of PCS** to support the relevant CDRFI schemes in question. In situations where concessional support to CDRFI schemes implies an optimal allocation of limited concessional resources, a rigorous “intra-CDRFI” comparison of alternative risk financing options should guide resource allocation.

Support programme design and funding decision-makers could confirm that alternative support options under consideration – often including premium or capital support of varying amounts, as well as other forms of concessional support (see InsuResilience Secretariat 2019) – comply with the SMART Principles and the InsuResilience Pro-Poor Principles. In line with cost-benefit analysis and theory, **a guiding prioritisation criterion** for optimising “intra-CDRFI” choices between those options could be **the expected impact on poor and vulnerable countries’ and people’s resilience for each dollar of PCS provided and received (the “Value for Money” or VfM)**. To optimise resilience impact and value for money of limited public resources, to the extent feasible, donors and support programmes could follow a uniform, simple VfM model that makes funding decisions comparable and transparent. At the same time, VfM analysis should allow for sufficient context-specificity and flexibility to reflect priorities of countries receiving PCS or in which schemes receiving PCS are located.

Such a simplified VfM model ought to consider and weigh various factors. For the numerator (“**value**”, i.e. expected resilience impact), in the absence of universal resilience metrics, a limited number of central metrics that build on the [IGP M&E framework](#)¹⁷ and its established methodologies could be applied. Bias towards short-term impacts should be avoided to the maximum extent feasible.

- › **Projected number of beneficiaries** reached by the project in question (IGP indicator i.b, see [IGP M&E framework](#), p.5 for full methodology): A quantitative variable of central importance to an assessment of overall resilience impact. The contribution of proposed projects to the collective IGP target of 500 million beneficiaries is a central (though not standalone) criterion for funding decisions. Weighting adjustments ought to be allowed in case of special circumstances, such as small population and market size, which particularly applies to countries classified as “Small Developing States” (SDS) by the IMF (see Panda et al. 2021c). Given their vulnerability and economic disadvantages, many Small Developing States may well be eligible for PCS (see [Principle 5](#)). Their population and market size should hence not put PCS initiatives in these countries at a disadvantage in VfM comparisons.
- › **Protection gap**: the size of the pre-existing protection gap in the country and, specifically, the projected project contribution to the reduction of this gap are central variables to inform funding decisions. Protection gap metrics measure uninsured disaster losses as a share of total losses. Protection gap metrics used in VfM comparisons could build on IGP indicators i.a (reduction in protection gap, see [IGP M&E framework](#), p.12) and v.c (reduction in vulnerable people protection gap, see [IGP M&E framework](#) p.9) and should be further improved as more country specific information about the protection gap and innovative ways of measuring it become available. Panda et al. (2021c) note that as the protection gap closes and a substantial share of risks are transferred via CDRFI, “optimality considerations” regarding the optimal level of risk transfer given government preferences over debt and growth outcomes could play an increasingly important role in PCS VfM comparisons.
- › **Suitability of the PCS-supported CDRFI product**: In line with GRiF appraisal criterion C.2 (Value for money and suitability of the product), “value for money, impact and any risks of the product relative to expectations and needs

of the client and relative to other potential feasible options that could be taken to achieve the stated objectives.” The added value of the CDRFI product in question ought to be demonstrated –quantitatively and qualitatively, i.e. including through information on the possible impact of PCS-supported CDRFI coverage on beneficiaries – in the country’s CDRFI strategy, and this assessment should be reflected in the VfM model.

In the denominator (“**money**”, i.e. PCS provided and received), in addition to the absolute PCS amount in USD, the VfM model could take the following into account:

- › **Relative performance of premium vs. capital support in financial terms**: A persistent question to date has been how the VfM of providing premium financing relates to the VfM of capitalizing the respective risk carrier, in particular given differential quality of funding used for this (see below). Financial analysis of capital vs. premium support for sovereign risk pools (see Vivid Economics et al. 2016 and World Bank 2017) indicates that the (cost-) effectiveness of macro-level PCS in terms of financial value to countries participating in the pool depends on a host of conditions, including the condition of global reinsurance markets and levels of capital held by the pool. Experience of the operational risk pools (Martinez-Diaz et al. 2019) confirms that **under current market conditions and capitalisation levels, premium financing is often more effective in helping countries access insurance coverage and therefore attracting policyholders**. In a quantitative VfM model, hence, a PCS relative performance score could be constructed that depicts the difference in financial performance between the two support types. Its technical details should be calibrated in an evidence-based fashion.¹⁸
- › **Relative performance of premium vs. capital support in attracting private capital**: Given the centrality of private capital in ensuring meaningful insurance coverage and the catalysing role that public support can play in market-based sovereign insurance, the score should moreover include **an assessment of the extent to which the PCS instrument in question crowds-in rather than crowds-out private capital** (and allows for optimised use of capital substitutes, such as re-insurance capacity) and avoids distortion of functioning markets.

¹⁷ This could be complemented by additional programme- or sector-specific metrics, such as [World Bank \(2021\)](#) or the relevant GRiF Appraisal Framework criteria.

¹⁸ I.e. based on the analysis undertaken by Vivid Economics et al. (2016) and World Bank (2017) for example, but noting that “there has been a lack of detailed quantitative analysis of impacts and effectiveness of different kinds of concessional support to risk pools added to the fact that the number of risk pools has been low mostly in low-income countries” (Panda et al. 2021a, p.9).

› **Concessionalality and type of financing: VfM analysis should be cognisant of different types of financing and their different levels of concessionalality**

considered in comparative analysis for funding decisions. More concessional funding for PCS (grants) promises greater CDRFI coverage volumes and hence more direct resilience benefits than less concessional funding for PCS (loans) of the same face value.¹⁹ VfM analysis across different levels of concessionalality would benefit from comparing VfM of the grant element²⁰ rather than of face value amounts of different PCS options.

Best estimates on the relevant variables should be made available to funding decision makers at the time of decision on concrete project proposals, and as early as feasible and reasonable. Recognising challenges with practical VfM assessments in the initial phases of a project, for maximum consistency between ex-ante projections of project impacts and ex-post M&E data, the same methods need to be followed. Moreover, rather than exclusively prepared by “project owners” or task teams, ex-ante VfM assessments should be performed or at least reviewed by external experts such as applied research institutions. This would mitigate bias in assessing impact towards obtaining the desired result and promote accountability of funding allocation frameworks. In addition, these frameworks and **VfM models should be regularly re-examined and adjusted in the light of experiences gained and improved data becoming available** (see also).

A Accessibility

To whom (which countries) should premium and capital support be provided? Under what conditions?

PCS is likely to be successful in durably improving CDRFI affordability and sustainability only in cases where it translates into greater CDRFI access. As stressed throughout this note, beyond the cost of insurance, societal, cultural, legal and institutional factors similarly determine the extent to which insurance solutions will effectively be accessed. Without an enabling environment consisting, inter alia, of adequate legal frameworks, and technical and human capacities, self-sustained CDRFI access for countries (or groups within them) will remain out of reach. Therefore, to improve their accessibility, **an environment enabling government and CDRFI stakeholders to partake in proactive Disaster Risk Management (DRM) is needed, stressing the importance of measures such as technical assistance that accompany PCS.**

PCS should be provided to countries that show strong political commitment – as a proxy of conditions that will enable greater access – but lack the necessary resources to effectively implement risk finance solutions. Country or policyholder ownership of CDRFI efforts is crucial. PCS-supported risk transfer instruments need to be demand-driven and respond to the needs of local stakeholders.²¹ In this context, governments’ willingness or credible commitment to contribute own resources or forego public revenue (e. g. through tax breaks) in order to increase CDRFI uptake should be specifically valued. PCS-supported countries should demonstrate readiness and dedication to work on CDRFI solutions (cf. GRiF criterion B.2), such as through credible and high-quality CDRFI plans and policies integrated in Nationally Determined Contributions, National

19 Concessional loans by development banks have in multiple instances been used for the coverage of annual premiums to the sovereign risk pools. While this improves affordability of pool participation for countries, the implicit form of subsidisation (through favorable loan terms) still requires a financial commitment (on the use of their development bank window) from recipient countries, promoting value recognition, ownership (see [Principle A](#)) and risk-reducing incentives (see [Principle R](#)) ([World Bank 2017](#)). At the same time, using highly limited repayable loans for non-productive insurance premiums (protecting development gains rather than providing future returns for servicing debt) raises questions about long-term debt sustainability for countries with increasing debt obligations, and on opportunity costs given competing development and public investment needs (Panda et al. 2021). As PCS should avoid intensifying debt sustainability challenges, due consideration should be given to the use of grant-based instruments where feasible. In this context, particular attention should be paid to countries’ fiscal and public debt stress when considering concessionalality and type of financing.

20 “The grant element reflects the financial terms of a transaction: interest rate, maturity (interval to final repayment) and grace period (interval to first repayment of capital). It is a measure of the concessionalality (softness) of a loan. It is calculated as the difference between the face value of a loan and the discounted present value of the service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value” ([OECD 2004](#)).

21 The suggested framework for recipients to suggest implementation partner preferences (see [Principle T](#)) contributes to country ownership and demand-drivenness.

Adaptation Plans, and/or V20 Prosperity Plans. In line with these arguments, ARC (2021) suggests various criteria measuring “commitment from the member states” such as historical pool participation, credibility of plans for self-funding premiums, and quality of and expenditure on general DRM policy. Such criteria could be applied to other pools or risk transfer solutions to inform PCS allocation decisions.

Yet, to truly make CDRFI more accessible, PCS should allow for **flexibility with regard to context and timing**, and hence define sufficiently flexible criteria for the above. With regard to context, for instance, in many cases effective pre-arranged money-out systems²² such as **adaptive social protection programmes** may greatly benefit speed and efficiency in administering disaster relief. In other cases, greater flexibility in allocating pay-outs to different disaster response and reconstruction needs is a key benefit for country policyholders. In the latter case, the “development mandate” of a PCS-supported risk transfer scheme should however be guaranteed, and evidence should be provided that this flexibility will not compromise inclusive and equitable outcomes and development gains. Flexibility with regard to timing, moreover, could be expressed in not making PCS contingent on pre-existing fully-fledged DRM institutions, policy and measures but to allow for their build-up during the initial timeframe of support (i.e. 3+ years), and extending additional support for this where necessary.

How much premium or capital support should be provided?

For risk layers in which risk transfer is appropriate and most efficient, risk transfer instruments need to be made accessible at a cost that is affordable to those who stand to benefit from them. In terms of respective premium shares covered by PCS and payable by the policyholder, this means that **PCS levels should be needs-based and hence be set at least “at the minimum level to make a project viable”** (GRiF criterion B.1).²³

So far, premium subsidy levels have historically been set “in a somewhat ad hoc manner, based on perceived need” (Vivid Economics et al. 2016, p. 50). In the light of principle “T” (transparency and consistency), however, **transparent, uniform and consistent criteria for needs-based PCS levels should be formulated**. Some experts suggest that these would, for instance, reasonably “be codified in terms of expected disaster losses and their relation to government budget or GDP” (ibid). Along these lines, for macro-level programmes, the suggested approach offering indicative guidance for PCS to be “sized” is as follows:

$$P_e = t_n * \frac{\text{expected contingent government liabilities from disaster}}{\text{total government budget}}$$

$$\text{where } P_e + P_p \text{ and } P_a = 1$$

Where P_e is the externally-supported premium share, P_p is the remaining premium share payable by the policyholder (country), and P_a is the full, actuarially priced premium charged by the risk carrier. t is a scaling factor that could decrease (or, under specified conditions, increase) annually (year n), although – crucially – in a pre-defined manner. Beyond needs-based considerations reflected in the fraction, Panda et al. (2021c) point out multiple performance indicators (changes in the financial protection status of the country, investment in adaptation and improvement in disaster preparedness and resilience, and novel indices constructed for this purpose) that could inform the definition of t . Building in such measures of progress made by countries in providing enabling conditions would make allocations performance-based and further ensure resilience-building incentives of PCS. PCS programmes should arrive at viable, consistent and transparently communicated scaling factors. In line with the need for clear plans for earmarked budgeting resources for future premium payments (see [Principle 5](#)), the supported premium share would decrease over time with increasing overall (and, by extension, Disaster Risk Reduction-related) government budgets.

22 “Money-out systems” refer to systems and plans in place using money to reduce disaster impact, e.g. pre-agreed plans for using and delivering funds or disbursement channels. See Centre for Disaster Protection (2020).

23 As stated above, this is true for risk layers in which insurance is appropriate and most efficient. As pointed out under “R” as well as by Panda et al. (2021c), PCS levels should be set with reference to a lower bound threshold beyond which PCS might lead to unsustainable outcomes.

R Resilience-building incentives

Under what conditions should premium and capital support be provided?

PCS should incentivise countries to pre-arrange funding for disasters in an integrated, strategic way, avoiding threats of maladaptation and “moral hazard”.

International support initiatives should encourage and enable countries to develop and apply a comprehensive, risk-layered Disaster Risk Financing (DRF) strategy. For an optimal allocation of resources between (i) risk transfer and risk retention and (ii) risk mitigation and risk reduction, **PCS should not unduly favour risk transfer solutions over the reduction of risks.** In terms of risk-layered DRF approaches, PCS initiatives should moreover give necessary consideration to potential perverse incentives – such as unduly favouring a specific risk financing instrument over a more appropriate one – created by the structuring of subsidies (see GRiF criterion B.3).

Risk-reducing behaviour should be stimulated by linking PCS provision to the build-up of “minimal DRM requirements” (Vivid Economics et al. 2016 p.50), such as the minimal contingency planning required to join ARC. This is in line with the idea to provide PCS predominantly to countries and schemes with evidence-based and effective pre-arranged money-out systems and plans in place, or with credible plans to put these in place within the support timeframe (see Principles [S](#), [T](#)). For these requirements to realise the intended impact, some experts suggest establishing a “credible mechanism for withdrawing [PCS] if these activities are not adopted”, though trade-offs with country ownership considerations ought to be taken into account. **Flexibility to account for contingencies ought to be built into such mechanisms** (see [Principle A](#)), and additional, complementary support should be extended for the build-up of these DRM requirements where needed.

How much premium or capital support should be provided and when?

While more evidence for risk-taking behavioural effects at the macro-level is needed,²⁴ PCS initiatives should set incentives for sovereign-level risk reduction (e. g. through regulation, policy and investment schemes) through premium pricing where appropriate. For premium support, the level of subsidisation (also if declining over time) ought to be set **such that the remaining premium share payable by the policyholder government (P_p) continues to systemically reflect risk levels despite subsidisation.** Even when cushioned by PCS, keeping a “price tag” attached to risk should continue to signal risks and guide decision-making.

While typically less of a threat for capital support, providing capital should similarly avoid potentially inefficient incentive distortions. In addition, beyond physical risks, reputational risks for PCS initiatives should be reduced by ensuring that capital injections to macro-level insurance vehicles (e. g. risk pools) do not directly or indirectly facilitate investments detrimental to containing climate change on the asset side of the vehicles’ balance sheet, such as fossil-intensive infrastructure or other investments underperforming on socio-economic outcomes (Panda et al. 2021a). On a related note, **incentives created by PCS initiatives should be such that they prevent rent-seeking behaviour and the capturing of undue private market rents.** While greater engagement of the private sector in sovereign-level risk finance can be a co-benefit of PCS initiatives, losses in overall economic efficiency and political legitimacy of PCS due to subsidies unduly benefitting private insurers are to be strictly avoided.

²⁴ Vivid Economics et al. (2016) for instance argue that “moral hazard” effects in situations of subsidised sovereign insurance are likely to be small or negligible, given that triggers are usually parametric (and hence “behaviour-neutral”) and given the small size of payouts (intended for immediate disaster relief) compared to overall losses.

T Transparency and consistency

Under what conditions should premium and capital support be provided?

PCS initiatives should be accountable for delivering the resilience benefits they promise to vulnerable people through the provision of limited concessional public finance. In addition, they can be made comparable (see [Principle M](#)), synergistic and more effective through coordination among support offers and providers. Transparency and consistency are crucial in the following areas in particular:

- › **Transparency towards PCS recipients:** Governance structures for decisions around PCS (e. g. on allocation of premium support to eligible applicant countries) need to be inclusive and transparent. **Accountability must take the intended “beneficiaries” into view** (and thus extend beyond accountability to donors). Conditions of PCS access should be transparent, and – while allowing for context-specific adjustments – should not differ across support providers. Empowering PCS recipient countries, these should be in a position to select their preferred partners (implementers/Multilateral Development Banks, risk pools, private sector providers) and/or their preferred risk transfer product options. Such a framework for recipients to select preferences for PCS partners could help to ensure that premium subsidies go towards policies that make most sense for recipients, and it crucially depends on inclusive governance structures. **The IGP is well positioned to promote such transparency by providing an overview of implementing partners and PCS options** for which countries and other CDRFI stakeholders might be eligible.
- › **Transparency towards the public: PCS project documentation should be made publicly available.** This should build on the type and level of detail for loan-financed projects delivered by development banks, i.e. include disclosure of a clear project development objective, detail on the financial product, and significant transparency over what contingent expenditures the insurance will finance. In addition, it is crucial that PCS initiatives are rigorously monitored and independently evaluated. M&E documentation should similarly be made publicly available, including to improve PCS decision-making frameworks such as the one presented here in future (see [Principle A](#)).

- › **Transparency among providers of support towards each other for greater synergies and consistency:** PCS is part of a wider array of financial and technical support mechanisms. These should be used strategically and in an integrated manner. In this context, sufficient information and data exchange and a “level playing field” between support programmes (including private sector initiatives) are crucial for coordinated use of complementary support instruments. ARC (2021, p.8), for instance, argues that it is “important to ensure that a country does not benefit double [...] from] premium support from various partners while other countries in such need are left without any form of external support”. More transparent and better-coordinated support between providers moreover sends more consistent messaging to potential support recipients, which avoids confusion and mistrust.
- › **Transparency of money-out systems in recipient and products countries:** An important pre-condition to PCS enabling tangible change in the lives of members of low-income and at-risk communities are transparent execution processes of client/recipient countries and institutions when utilizing pay-outs from the risk transfer mechanisms supported by PCS. Transparent execution processes and – where beneficial – the use of pre-defined money-out systems (e. g. adaptive social protection systems) must ensure that risk transfer effectively serves the most vulnerable (see also Principles [S](#) and [R](#)).

For how long should premium and capital support be provided?

The need for transparency on support conditions extends to clarity about how long PCS, in particular premium financing, will be provided for. By setting out clear plans for multi-year premium support that comprise exact end dates (as well as intermediary progress indicators) and strategies for how and by whom premiums will be paid after support termination, PCS initiatives increase reliability of macro-level PCS. As opposed to ad hoc, year-on-year decisions (as to whether premiums would be externally financed or not) this approach provides governments with the ability to more effectively plan own budget expenses in complementary activities or towards other development outcomes, and industry with certainty about investment conditions.

II. Applying the SMART Principles at the Micro- and Meso-Level

The amount and size of micro- and meso- insurance schemes in low-income developing countries has rapidly increased in recent years. Many of these initiatives have been supported technically and financially in a variety of manners, including via PCS. This section therefore applies the SMART Principles to support initiatives at the micro- and meso-level.²⁵

S Sustainable impact for the most vulnerable

To whom (which micro-level actors) should premium or capital support be provided and when?

To realise tangible change in the lives of those most vulnerable to disasters, PCS initiatives should be extended to micro- and meso-level schemes specifically targeting these population segments in vulnerable countries (i.e. those countries and people belonging to the InsuResilience target group).

Similar to the macro-level, at the micro- and meso-level, two potential rationales for PCS provision and use can be distinguished (see Hill et al. 2014, though in practice often intertwined), as PCS can aim to improve affordability and sustainability of risk transfer solutions by

- (a) **Market-building or -enhancing:** by eliminating market failures and economic inefficiencies (e.g. externalities, asymmetric information or high fixed costs), which in turn lowers cost, builds viability of business models, enabling conditions (e.g. “insurance culture”) and potentially self-sustaining insurance markets and thereby improves affordability indirectly.
- (b) **Improving equity of coverage:** by providing excluded groups, such as low-income households, with better access to insurance through direct premium reductions, even in cases where in purely micro-economic terms self-sustaining business models might not be viable. This may be the case despite cost-effectiveness and efficiency of CDRFI approaches, which however need to be assessed on a case-by-case basis. The relative efficiency of PCS to public social security schemes should in these cases always be compared to PCS for market-based solutions.

PCS for micro-insurance can moreover be either designed as “universal” or as “targeted”, in the sense that either all clients of a particular insurance vehicle or a selected sub-group benefit. While capital support is always universal (and for a focus on the most vulnerable should hence be limited to insurance providers with a distinct development focus including local insurers in low- to lower-middle-income countries), premium support can be more targeted. Especially in contexts where rationale (b) is more important, **premium support initiatives should specifically be targeted to lower income households, as universal premium support is likely to benefit richer households** disproportionately (see Panda et al. 2021a) (see [Principle A](#) for a discussion of flexibility required for adequate targeting of lower income households).

On a related note, PCS can reduce premiums charged from individual clients by channelling funding either to the insurer or directly to the purchasers of insurance. While capital support is by definition provided to the risk carrier (and thus benefitting the insured indirectly), premium support could in principle be provided to either. Yet, in the case of micro-insurance schemes, evidence suggests **that it is usually preferable to provide subsidies to the insurer to indirectly benefit individuals rather than subsidizing the premium rates paid by individuals directly** (see Panda et al. 2021a). As further expanded on below (see [Principle T](#)), it is nevertheless imperative to not unduly favour single market actors over competitors, posing the need to adapt the concrete design of PCS schemes to local markets.²⁶

²⁵ In the following, micro-insurance refers to micro-products to insure the most vulnerable individuals in low-income countries (parallel to the concept of micro-finance);. This also includes micro-insurance offered through public schemes. Meso-insurance refers to those situations in which the insured is not an individual, but rather an aggregation of individuals under a collective body or enterprise.

²⁶ This is further determined by antitrust regulations, which in conjunction with the IDF operating principles prescribe the offering of insurance capacity at competitive prices.

For how long should premium and capital support be provided?

Transitional subsidy strategies have proven to be highly effective to promote the uptake of new technologies and approaches. This is true in particular in case (a), in which **PCS could in theory be phased out once market failures have been overcome** (e.g. when fixed costs are distributed sufficiently to reach viability through increased economies of scale). This crucially includes overcoming market inefficiencies caused by “information asymmetry” through improved consumer understanding of insurance (i.e. allowing for a PCS phase-out when sufficient value recognition on the part of beneficiaries is built up). Accompanying measures for PCS should include activities for client empowerment (see [Principle A](#)). In case (b), on the other hand, **PCS to improve the equity and inclusiveness of insurance coverage (preferably as part of a social safety net) may be in place for as long as there are individuals who require assistance in purchasing insurance.**²⁷



M Value for Money

How much premium or capital support should be provided?

A micro-level VfM model for PCS could take inspiration from the macro-level one introduced above. Specific consideration should be given to the following in the adaptation of a VfM model:

- > **Beneficiary estimations** should employ methods specific to the micro- and meso-level (see [IGP M&E framework](#) p.4) and could specifically assess contributions to IGP indicator i.c. Methods to assess the suitability of PCS-supported CDRFI product should similarly be adapted to the micro- and meso-level, and entail an assessment of the extent to which the product in question provides real value-added (including co-benefits) to insurance clients.
- > Any method to assess resilience impact (“value”) of PCS provided to micro- and meso-level initiatives should factor in **indirect benefits achieved through the realisation of the market-building potential**. Since well-functioning, rules-based, efficient and competitive domestic insurance markets are a precondition to the availability of affordable private insurance solutions to households and businesses in vulnerable countries, market-building or -enhancing potential should be adequately taken into account. Especially for smaller economies including **Small Island Development States (SIDS)**, PCS initiatives supporting market-building approaches can overcome market failures (e.g. a smaller market size that can present a barrier to introducing and sustaining micro- and meso-insurance). By facilitating the expansion of private insurance on offer at affordable prices, they can generate temporally and spatially disconnected benefits to people not strictly covered by common “headcount” measures. Factoring in market-building potentials could build on IGP indicator iv.c (Competitive private insurance markets) but also calls for capturing more detailed information that goes beyond the IGP M&E framework (e.g. individuals’ and businesses’ awareness of and access to risk finance or the uptake of climate resilient business models).

²⁷ The average income levels of insurance clients should increase if insurance can generate socioeconomic gains or protect livelihoods, which in turn in most cases should reduce the need for external assistance.

- › When assessing and comparing VfM of various alternative micro-/meso-level PCS options – and in particular when factoring in market-building potentials in these assessments – VfM analysis should keep in view that other forms of concessional support (e. g. reinsurance support, operational subsidies and general risk reduction measures, see [InsuResilience Secretariat 2019](#)) may be better suited to enhance the viability of the insurance scheme through enhancing product design, distribution channels, payment systems etc. **In many contexts where disaster risk insurance markets are new and emerging and suffering from various inefficiencies, it can be more (cost-)effective to first or at least simultaneously invest in addressing inefficiencies in insurance markets, before considering traditional premium subsidies (Hill et al. 2014).** In addition, from a cost-benefit perspective, insurance might not always be the best solution to address climate risks for the extremely poor and poor. Donors and governments should only provide PCS for products that are **needs-based, adjusted to the local context and embedded into holistic risk management and resilience-building strategies** (MCII 2016). This includes the imperative to ensure that PCS-supported CDRFI schemes are **gender-responsive** in line with the InsuResilience Declaration on Gender.
- › When assessing the cost-effectiveness of a marginal dollar of support for a PCS project, implications for the remaining premium share payable by individual policyholders should be kept in view. Specifically, the context-specific **elasticity of demand for insurance should inform the size of the envisaged premium reduction** (see Panda et al. 2021a, 2021b). Greater evidence on price elasticity of insurance demand should be generated for more contexts and geographies.
- › Regarding the concessionality and type of financing of micro- and meso-level PCS, **the liquidity (or working capital) of the households or MSMEs targeted** by the insurance schemes under consideration should be taken into account.

A Accessibility

Under what conditions should premium and capital support be provided and used?

At a micro- and meso-level, PCS ought to be employed to enable people and businesses to receive the insurance cover they need at a cost they can afford (MCII 2016). To allow for increased uptake, risk transfer instruments need to be made accessible at a cost that is affordable to those who stand to benefit from them. In addition, financial support aimed at lowering cost barriers must be accompanied by measures empowering at-risk communities and enabling access despite pre-existing non-cost barriers. Accessibility, in this sense, can be understood to comprise the following components, each with distinct implications for PCS design and conditions:

- › **Demand-side accessibility:** Most often, the poorest and most vulnerable cannot afford insurance at market prices. For PCS to enhance access to micro- and meso-level insurance, it must focus on improving both **financial accessibility** (i.e. cost) of these products by lowering the payable premiums. PCS therefore needs to be **flexible**, i.e. adjustable to factors that determine affordability of the insurance product for the beneficiary, such as changing and unpredictable income from informal sources, as well as evolving resilience or hazard exposure (for (climate) risk adjustment). Regarding **non-financial aspects of accessibility**, PCS should moreover concentrate on micro- and meso-schemes that utilise functioning, locally-adapted delivery channels for product delivery and distribution (premium payments, contractual transactions, possibly pay-outs), and which **promote equitable access across all genders**. Innovative solutions should be actively encouraged through PCS initiatives. PCS should focus on contexts in which additional support is available for the build-up of such enabling distribution channels, financial literacy, and climate risk awareness; or be specifically accompanied by additional assistance to also support these enabling factors.

- › **Supply-side accessibility:** Underinsurance and the lack of insurance options accessible at affordable prices for individuals arises not only from a lack of viability due to low demand-side income levels, but also from imperfect supply-side conditions (e. g. market inefficiencies, see above). The lack of “insurability” for specific perils often translates into prohibitively expensive insurance products or into insurers refraining from offering insurance products. **PCS initiatives focused on purpose (a) (market-building or enhancing) should hence aim to make otherwise unviable market segments accessible to micro- and meso-insurers**, overcoming the lack of “insurability” and strengthening supply-side accessibility, for instance by helping to overcome issues such as small market size resulting in the lack of economies of scale. In many cases, PCS ought thus to be accompanied by complementary enabling interventions to support the building of sustainable insurance markets, such as technical assistance for the creation of consumer awareness and the building of distribution channels.

R Resilience-building incentives

To whom (which micro-level actors) should premium and capital support be provided?

Where feasible, PCS – in particular premium support – ought to be targeted. This is true also with respect to incentives, as (universal) subsidies benefitting higher income customers can undermine efficiencies and incentives within the insurance industry, encouraging beneficiaries to overinvest in risky and damaging activities (see Panda et al. 2021a; Hill et al. 2014). “‘Smart’ subsidies are designed and implemented in ways that provide maximum social benefits while minimizing distortions in the market and mis-targeting of clients” (Hill et al. 2014, p.v).

How much premium or capital support should be provided?

For premium support serving rationale (a) (market-building or enhancement), the imperative to avoid incentive distortions means that **premium support to micro- and meso-level beneficiaries should be partial (i.e. less than 100 % of the market premium)** in a first step. Moreover, levels of premium support should be set on a proportional basis rather than by establishing premium caps at a defined value (Hill et al. 2014). In terms of premium composition, as a general rule levels should be set so that the subsidised net premium payable by the beneficiary is not less than the pure risk premium (Panda et al. 2021a). Depending on context, this could for instance mean that premium support covers the mark-up part while clients continue to pay for most of the risk-based part of the premium, or it could mean subsidizing a set percentage of the market premium (Vivid Economics et al. 2016). In cases where insurance products might still not be affordable without external support for the risk-based part of the premium – specifically those serving rationale (b) (equity of coverage), **innovative DRF approaches such as insurance-for-work programmes can help to make the risk-adequate premium affordable** (see MCII 2016). For rationale (b), moreover, the need for PCS exceeding the threshold described above could be assessed on a case-by-case basis.²⁸

Under what pre-conditions and conditions should premium and capital support be provided?

In order to not distort incentives between risk transfer and risk mitigation, micro- and meso-level PCS should be complemented by **investing in risk reduction measures and an enabling environment to indirectly reduce premiums** (MCII 2016). Technical assistance can also present a potential support form to foster risk transfer and mitigation efforts, thereby contributing to the sustainability of PCS.

²⁸ The proposed learning plan (see [Principle A](#)) could include follow-up work on a more detailed methodology for the assessment of premium support levels on a micro- and meso-level, taking into account the general considerations mentioned in this section.



T Transparency and consistency

For how long should premium and capital support be provided?

Reflections on macro-level transparency and consistency (see above) to ensure complementarity between support initiatives also apply at a micro- and meso-level. In addition, **PCS initiatives to support micro- and meso-insurance must comply with competition regulation, and not unduly favour single market actors over competitors.** Hence, PCS initiatives – specifically those aiming to achieve rationale (a) – must transparently communicate support conditions, timeframes and phase-out plans. The selection of private sector partners must hence inter alia follow best practice for transparent tendering processes. In parallel to the macro-level, transparency should extend to recipients and communities at risk, other support providers, donors and the

general public. In line with considerations on the learning plan below (see section B.III), this type of transparency responds to the need to share information and knowledge to build more experience and evidence. Moreover, multi-year support should be clearly planned and budgeted for as such from the outset. From a support recipient and user perspective, “reliable external support that ensures a long-term perspective for the insurance product is a precondition for the engagement of private sector actors in the market development for the very poor segment of society in vulnerable countries” (MCII 2016 p.40, Panda et al. 2021a). Similarly, reliability is crucial for households and businesses to plan. At the same time, the provision of a reliable and predictable source of support to those with little adaptive capacity and disproportionately affected by climate change is a central component of an equitable and just response to climate change ([see Building Block II in Annex](#)).



Conclusion

The Principles for SMART Premium and Capital Support contained in this Policy Note (Part A) set the stage for scaled-up action on enhancing CDRFI affordability and sustainability on the ground. They offer conceptual guidance for the provision, channelling and use of PCS by donors, implementers and recipient through new and existing programmes.

Part B of this Policy Note contained conceptual guidance for these programmes and other stakeholders on the application of the SMART Principles at both a macro- and meso-/micro-level. Yet, as noted, the PCS decision-making framework offered should be subject to further evolution over the coming years. **Technical follow-up work is warranted to specify suitable methodologies for multiple criteria proposed here, in particular the following:**

- › metrics, indices and thresholds for poverty and vulnerability/risk (see [Principle S](#));
- › the calibration of a PCS relative performance score (see [Principle M](#));
- › the weighting of VfM model factors (see [Principle M](#));
- › the definition of scaling factors t_n for setting appropriate amounts of PCS to be provided (see [Principle A](#)), as well as work on a more detailed methodology for the assessment of premium support levels on a micro- and meso-level (see [Principle S](#)) that allows for sufficient flexibility (see [Principle A](#)).

Generally speaking, however, these methods should be simple, entry barriers low, and allocation rules straightforward. They should be **refined over an initial time period during which experience with scaled-up, principled provision and use of PCS is gained**. Additional areas of necessary and desirable follow-up work include supporting recipient countries in articulating their specific PCS needs in quantifiable, monetary terms, as well as the provision of an overview of existing PCS programmes and access criteria.

Follow-up work may hence be sequenced in multiple phases and guided by an initially established research and learning plan. This is partly because currently there is not enough evidence and even less experience with what the “right” criteria and methods are to translate the principles into practice, i.e. those that will promote a sustained increase in high-quality prearranged CDRFI over time. This research and learning plan should provide detail and guidance for research and learning in this area, building on the respective InsuResilience Evidence Roadmap’s evidence priority (see [footnote 8](#)).

Central elements that a more detailed research and learning plan centered around this evidence priority should comprise are the following:

- › research on optimality conditions for PCS in comparison to other CDRFI- and non-CDRFI support tools (“Are subsidies for CDRFI good use of public resources in a given context, and how is this determined?”, see [footnote 8](#));
- › the need for additional evidence on effective ways to ensure a development focus of money-out systems in cases where flexibility in allocating payouts is a key benefit for policyholders;
- › public and independent, robust M&E that allows to include accountability and learning (MEAL);
- › the need for greater evidence on price elasticity of insurance demand (in particular at the micro- and meso-levels) for more contexts and geographies;
- › additional evidence on most suitable (climate) risk indices to inform allocation decisions, including, if necessary, the construction of novel indices for this purpose (see also [footnote 12](#));
- › the dynamics of supply-side constraints and the role of PCS in boosting regional risk pool membership and market size.

Based on the considerations introduced in this Policy Note as well as on the Evidence Roadmap, the IGP will develop a dedicated learning plan for the SMART PCS decision-making framework.

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Annex

Building Blocks of Effective Climate and Disaster Risk Finance and Insurance

In light of the increasing frequency and severity of climate and disaster impacts, compounded by the COVID-19 pandemic, **it is vital to protect people better from disasters by improving supply and use of Climate and Disaster Risk Finance and Insurance (CDRFI)**. In order to do so, CDRFI instruments whose affordability and sustainability is to be strengthened through SMART premium and capital support ought to reinforce best practices for effective larger CDRFI beyond the narrower domain of concessional financial support. SMART premium and capital support can thereby strengthen the affordability and sustainability of effective CDRFI solutions.

The building blocks were consolidated in response to the G7 Foreign and Development Ministers' intention to develop best practices for effective CDRFI made at their Meeting on 5 May 2021 (see [communiqué](#)). They were developed as a joint effort between the Centre for Disaster Protection, the Global Risk Financing Facility (GRiF)/World Bank, the IGP and in coordination with the UK G7 Presidency's workstream on Disaster Risk Finance.

The following **building blocks of effective CDRFI** fundamentally draw upon existing CDRFI frameworks and evidence from their implementation. They aim to consolidate the experience of key actors and are an attempt to align the following frameworks that are pivotal to guiding global action on CDRFI:

- › [The Centre for Disaster Protection's Seven Keys to Unlock Highly Effective DRF](#)
- › [The Global Risk Financing Facility's Guiding Principles and Appraisal Framework for Grant Support](#)
- › [The InsuResilience Pro-Poor-Principles](#)
- › [The InsuResilience Declaration on Gender](#)

Building Block I: Beneficial Impact for Poor and Vulnerable People

CDRFI should enhance the financial preparedness and resilience of all economies and people against disaster and climate shocks, especially those that are the most vulnerable to such shocks. To ensure that CDRFI benefits the poorest, most vulnerable and marginalised communities, including women and girls, CDRFI approaches should be equitable, lead to direct impacts in the lives of the poorest and most vulnerable people, and be reported through transparent M&E.

Building Block II: Assure Solidarity with Vulnerable Countries and Communities

The financial cost of risk finance solutions should be borne in a manner that reflects solidarity with those countries and communities that are the most vulnerable to and hardest hit by climate disaster. Therefore, the provision of concessional financial support for CDRFI arrangements should be in line with the **SMART Principles on Smart Premium and Capital Support**.

Building Block III: Create Empowerment and Ownership

CDRFI approaches should be locally engaged where possible and designed to ensure strategies and approaches are demand-driven and respond to the needs of local stakeholders and people most at risk. Solutions design and implementation processes should be inclusive and support the development of local capacities that allow for informed decision-making and risk managing by all relevant stakeholders.

Building Block IV: Ensure Complementarity of Efforts

Financing for disasters should not happen in a vacuum. CDRFI approaches and instruments need to suit the context and be integrated in a coherent and comprehensive disaster risk management strategy for reducing and managing all risks for the most vulnerable people in a country. Moreover, CDRFI should build in incentives for reducing risks rather than just responding to them. Complementarity of efforts improves disaster protection via collaboration and transparency between all stakeholders, complementarity between instruments at different levels and for different groups through a risk-layering approach, and alignment with wider resilience measures.

Building Block V: Leverage the Private Sector for Upscaled and Innovative Solutions

Financial markets should help share risks efficiently among public and private stakeholders and mobilise additional funding. CDRFI should promote the development of efficient, inclusive and stable financial and insurance markets and institutions in all countries vulnerable to disasters. Public support to CDRFI approaches should reinforce and where necessary create the “business case” for the international and domestic private sector as providers of risk capital, skills, capabilities, and as an engine for CDRFI innovation.

List of abbreviations

ADRIFI	Africa Disaster Risk Financing Program
ARC	African Risk Capacity
ATP	Ability to pay
CDRFI	Climate and Disaster Risk Finance and Insurance
DRF	Disaster Risk Financing
DRM	Disaster Risk Management
GDP	Gross Domestic Product
GNI	Gross National Income
GRiF	Global Risk Financing Facility
HLCG	High-Level Consultative Group
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IGP	InsuResilience Global Partnership
M&E	Monitoring & Evaluation
PCS	Premium and Capital Support
SIDS	Small Island Development States
VfM	Value for Money
V20	Vulnerable Twenty Group
WTP	Willingness to pay

List of consulted entities

- › African Risk Capacity
- › Allianz*
- › Axa
- › Bangladesh*
- › Canada*
- › CARE International*
- › Centre for Disaster Protection
- › KfW Development Bank
- › Ethiopia*
- › European Commission*
- › Fiji*
- › France*
- › Germany*
- › GIZ
- › Global Parametrics
- › Insurance Development Forum (IDF)*
- › Institute for Climate and Sustainable Cities*
- › InsuResilience Solutions Fund (ISF)
- › Madagascar*
- › Microinsurance Network (MiN)
- › Munich Climate Insurance Initiative (MCII)
- › Philippines*
- › Republic of the Marshall Islands*
- › SLYCAN Trust*
- › Switzerland*
- › United Nations Development Programme*
- › United Nations Office for Disaster Risk Reduction*
- › United Nations Framework Convention for Climate Change*
- › United Kingdom*
- › V20 Secretariat
- › World Bank*
- › World Food Program*
- › World Resources Institute*

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