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Development Finance Forum

Insuring the SDGs

Managing Climate and Life Risks

Introduction

At the beginning of November 2016 experts from around the world attended the "Development Finance Forum" in Frankfurt, KfW Development Bank´s flagship event. Held annually, it usually focuses on a different current development issue. This year´s event, entitled "Insuring the SDGs – Managing Climate and Life Risks", covered insurance and its increasingly vital role in times of climate change and widespread health risks. While insurance cannot avert climate change or illness, it can mitigate calamities and losses by providing an ex-ante coordination and financing mechanism to avoid hectic and often not well coordinated disaster response. Without such additional risk buffers the Sustainable Development Goals (SDGs) cannot be reached.

Throughout the world, the international community is working on the development of insurance solutions, not least because the G7 countries at their summit in Elmau 2015 have committed themselves to insure an additional 400 million people against climate-related risks until 2020. In order to reach this goal – health insurance is also needed across the globe – new schemes have to be developed and scaled up, in particular schemes that include poor and vulnerable people. Against this background about 150 experts from around the globe, from the public and private sector, took stock of where we stand and were looking for ways to employ insurance principles to an even greater extent in development cooperation.

Participants of the Development Finance Forum

It was clear to all participants that risk management in its present form is not sufficient. It is costly, often inefficient, at times unorganised and almost always too late. Against this background the participants of the conference agreed that insurance can be an interesting instrument for development cooperation but that it has to be adapted: first of all, in order to really reach the intended target groups and secondly to keep premium payments reasonable and affordable particularly for the major target group.

In different presentations alternating with plenary discussions the experts looked at present challenges and possible solutions. Splitting up in four working groups – climate direct and indirect as well as health direct and indirect – these issues were discussed in detail with the experts involved. Subsequently they exchanged views across sectors. In the end the respective working groups came up with a set of recommendations that are compiled in this documentation of the conference.

Panel discussion on "leveraging the potential of insurance for SDG achievement"

Challenges

Insurance is a trend that is “formulated but not yet completely spelled out”, said Stephan Opitz, Member of the Management Committee of KfW Development Bank, in his opening speech of the Development Finance Forum. Over the past two years a number of international conferences have addressed the role of insurance: The G7 Summit in Elmau, the Paris Climate Conference and the World Humanitarian Summit – to name just a few. They all identified insurance as an important instrument on the road to creating additional safe-guards against impoverishment and achieving the SDGs.

Stephan Opitz’ (KfW Development Bank) introductory speech

“Here is something on the move”, said Opitz, but it has yet to be given direction and be made operational. In order to get it going Opitz stated the opinion that three things are particularly important: involving the private sector, designing new approaches and addressing more risks than climate-induced ones and – last but not least – scaling up existing and new schemes. KfW Development Bank, he said, was already engaged in several insurance projects and programmes, complementing its classical financial instruments. But KfW intends to increase its commitment in order to support the German Federal Government in reaching its international goals.

Ingrid-Gabriela Hoven, Director-General in the German Federal Ministry of Economic Cooperation and Development (BMZ) saw a sense of urgency in enhancing insurance because “climate change is already happening” and “the impacts will be heavier than expected”, particularly for the poor and vulnerable. “So, we have to take action, and we have to do it sooner than later.” Only two percent of the losses due to weather extremes are covered by insurance in developing countries. According to Hoven, there is a huge potential for including more people and more countries in cushioning climate risks but also in buffering health risks.

Ingrid-Gabriela Hoven (Federal Ministry of Economic Cooperation and Development)

Scaling up was necessary – and possible, said Hoven, because a number of factors have recently changed to the better. Among them are:

- Regulatory frameworks in many countries have been strengthened in the aftermath of the financial crisis.
- An unprecedented amount of money is available in development cooperation, including for innovative financial instruments.
- New information and communication technologies can assist and speed up the process.
- New partnerships with the private sector have emerged and are emerging that can be taken as models and examples for others.
- Insurance industry is interested and increasingly committed to development issues.
- The political backing is there and has been confirmed on different occasions, including at the World Humanitarian Summit and around the Agenda 2030.

However, in order to scale up and reach the “bottom billion” new avenues have to be taken, new approaches looked into. That in her opinion includes distribution paths as well as premium payments. “Let us not politicise the issue of premium payment subsidies”, Hoven said. If properly used and well applied they could be important in increasing risk protection via insurance. “Therefore the support for insurance approaches will be on the top of our agenda”, she said on behalf of the German Federal Government.

Leaving behind medieval financing mechanisms

The key note speaker, Stefan Dercon from the University of Oxford dug deeper into the topic by drawing a line from insurance to the SDGs. According to Dercon it was beyond question that insurance has an important role to play in fulfilling the Agenda 2030 because specifically the poor people around the world are exposed to hardships due to shocks. In Ethiopia for instance 95 percent of the population was affected by some kind of hardship, among them most common drought, illness and death. In general according to Dercon one third of poverty can be associated with adverse events, which led him to the conclusion that “adverse shocks cause poverty”. Thus, in his perception insurance can indeed make a difference in tackling poverty. Especially when included in a systematic contingency planning.

Key note speech held by Stefan Dercon (University of Oxford)

So far, in case of emergency countries follow, as Dercon put it, a “medieval financing” mechanism: they go around with the begging bowl – “inadequate and embarrassing for the 21st century”. All the more because on average only 43 percent of the needed money gets pledged, meaning next to the time lag there is usually also a huge financial gap. A gap insurance can close by shifting part of the risk management from ex-post to ex-ante.

As promising as insurance may be, however, it is connected to a number of challenges that have to be dealt with to make it a feasible instrument. Among them Dercon mentioned:

- The insurance markets for the poor are normally not developed. Therefore, transparent market-based contractual solutions for the bottom part of societies are needed. They have to include clear and transparent information as to when pay-outs will happen and what for.
- Premiums are often too expensive in relation to the payouts.
- If insurance schemes do exist poor people are not buying them in large numbers because the products are too complicated, because many people are “financial illiterates”, or because they do not trust the products.

That means according to Dercon: insurance in order to seriously address the poor and contribute to reaching the SDGs has to be an issue of public policy, not one of market development. And it should be regarded precisely as such by the respective politicians and donors. They should learn from the principles of insurance and maybe use it to “create more certainty in a world of uncertainty” but not leave it to the market itself because “insurance in itself is not the answer”. Rather it needs three ingredients to function properly:

- A fast, evidence-based decision-making process.
- A coordinated, credible plan for post-disaster action agreed in advance.
- Financing on standby to ensure that the plan can be implemented.

Otherwise “we oversell insurance”. It cannot solve all the problems, concluded Dercon. Instead “we need honest brokers” from the public scene in this.

The question of adequate resources

In several panel rounds and shorter presentations following the initial speeches representatives from governments, international institutions, the private sector and NGOs discussed further challenges of insurance. One of them is the financing aspect. Many participants considered premium payments as one of the major obstacles in further spreading insurance schemes against weather or health risks. While in the health sector there seems to be an international consensus that coverage of the poor must be financed by public budgets in the case of weather extremes this discussion is still going on. In order to reach higher acceptance by the target group the pay-outs are also quite critical. If they take place swiftly and on adequate levels then the interest will grow, argued several participants.

Panel discussion on “how do climate and health risks jeopardise SDG achievement?”

Another challenge was seen in insurance products themselves because many people simply cannot understand the risks and benefits involved. Thus, the need to develop easy-to-grasp products was emphasised as well as the necessity to better explain and convey its advantage.

Information in another sense was also repeatedly addressed during the panel discussions: many participants noted that the information and data basis on who could require what kind of insurance, under which conditions and circumstances and with eventually which impacts urgently needed to be enlarged. New digital solutions could play an important role as was reiterated several times in the plenary sessions.

Digitisation could also facilitate the distribution problem that otherwise makes it difficult to logistically reach the potentially affected by hardships – smallholder farmers, poor people in the countryside or in the outskirts and slums of larger cities. Since the prevalence of mobile phones is high even for instance in remote areas of Africa this could be a viable channel to enable broader access to insurance products.

Panel discussion on innovative insurance products

Another issue raised during the conference was the one on which risks could be covered aside from climate-induced risks and how: that holds true for pandemics for instance. Many participants found insurance schemes promising here as well but the details for widespread use, “getting it on the ground”, as somebody put it, are yet to be worked out.

Summed up the major challenges were seen in the following areas:

- Product design adapted to the needs and capabilities of the user.
- Smart design of premiums financing.
- Sufficient data basis.
- Creating trust by creating transparent markets and schemes.
- Explaining the products.
- (Physically) reaching the poor.
- Distribution of products.
- Division of labor between private and public sector and civil society.
- The regulatory framework.

After having defined the major barriers for the scale-up of insurance in general terms the conference split up into different working groups that were analysing the challenges in more detail and were looking for possible recommendations to improve existing schemes.

Working Groups

Health direct – solutions for universal health coverage

Achieving Universal Health Coverage (UHC) is a central element of the health-related SDG and was therefore also a topic at the Forum. UHC implies access to essential health services of appropriate quality as well as financial risk protection of individuals. But: which health services ought to be considered “essential”?, was one of the question participants debated. The answer will differ across countries, but should be based on objective criteria (burden of disease, cost-effectiveness of available interventions, health equity, etc.) while also taking societal preferences into account. Also, the range of services to be included in an essential package would always depend on the fiscal space available, several experts said.


Working group: health direct

To minimize the risk of health-related impoverishment, essential health services should be provided free of charge at the point of delivery, i.e. payment for and utilisation of health services are to be delinked, the working group recommended. In principle, this may be achieved through contribution - as well as tax-based health financing models. Irrespective of the model a country chooses it is important to make membership compulsory so as to prevent adverse selection and enable vertical redistribution. Wherever possible, efficiency considerations ought to be taken into account in the design of a health financing scheme. This relates to the mechanisms employed for revenue generation (e.g. payroll taxes will be insufficient in the context of low rates of formal employment), pooling (the lower the number of separate risk pools, the lower the total administrative cost) as well as purchasing (e.g. the possibility of establishing a purchaser-provider split). It was also agreed upon that hybrid approaches combining design elements of contribution- and tax-based health financing models may constitute an interesting option in this respect.

Reinsurers have a role to play in the establishment of national UHC financing mechanisms, was another point made during the discussion. In the case of relatively small schemes in particular, reinsurance companies may contribute to the sustainability of an approach by providing protection against covariate (e.g. pandemics) or macroeconomic shocks. In addition, technical assistance to promote the institutional development of national UHC financing schemes can be part of a reinsurance solution. The extent to which reinsurers will engage in health protection approaches in low-income settings will depend on the commercial viability, the potential to develop future markets as well as the impact on companies’ reputation. Whereas national governments need to set their own UHC strategy and determine the required regulatory framework, international development partners are required to finance start-up costs and / or coverage of poor segments of the population. Alignment and harmonisation of external support is of key importance, participants stated. Such support is no charity, but rather an important contribution to economic development.

Climate direct – insuring individuals and small enterprises

Kenn Crossley (WFP) presents R4 in the working group climate direct

The question of how to insure individuals and small enterprises against climate-related risks was guiding the working group on climate direct. After three insightful inputs of Kenn Crossley (WFP), Carlos Boelsterli (MiCRO) and Ashok Yadav (AIC of India) on different insurance models in different regional contexts, the participants engaged in lively debates on the following topics:

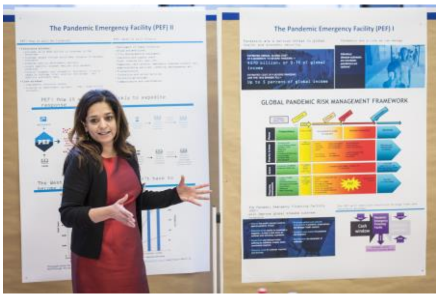
The role of insurance: As stated by the participants, the word insurance is ambiguous and should be considered from different angles. First, the focus was on insurance companies. According to the experts, these companies should play a critical role to identify and price risks. With regard to insurance as a broader concept, there was consensus that insurance represents an essential element within a risk management framework. However, it should not be considered a self-evident success and needs to be combined with other risk management tools (such as risk reduction and prevention). Furthermore, it was recommended that beside the insurance's protective role for individuals and small enterprise it should also serve to unlock productive opportunities, e.g. by improving farming practice and accelerating investments.

The form of insurance: This was discussed in the sense of whether insurance products should be bundled with other services or whether they should be offered on a stand-alone basis. Participants agreed upon the fact that insurance should always be bundled with other services as long as the downside risk can be managed effectively. Advantages of bundling include added values for the client, for example with regard to increased transparency through consultancy or consumer education. However, participants stated that a stand-alone insurance should be offered for people who cannot access other (bundled) products.

Different roles of different actors: Actors in the insurance framework are manifold and comprise for example partner countries, development partners and reinsurances. The variety of players makes insurance endeavors challenging. In this respect, the participants were convinced that all relevant stakeholders should choose a coordinated approach when it comes to developing socially inclusive insurance solutions. It was also agreed upon that in order to create social inclusiveness insurance solutions against climate risks need to take advantage of new technologies. Therefore, research and development, technical assistance and an enabling regulation play a crucial role.

Including the poor: In many countries, the poor are often the most vulnerable – especially when it comes to climate-related risks. According to the participants, smart subsidies are therefore needed to assure social inclusiveness in the sense of *leaving no one behind*. Insurance models need a critical mass in order to achieve effective risk pooling. Some experts indicated that subsidies could even help to maximise market efficiency.

Health indirect – containing outbreaks, preventing pandemics



Priya Basu (World Bank) explains the Pandemic Emergency Facility in her working group health indirect

Following the 2014 Ebola outbreak in West Africa the international community was slow to react, participants stated. The pandemic's social and economic impact would have been significantly less severe if the international response had come more swiftly. While all major reviews attributed the failure to act in a timely fashion to a combination of shortcomings in the global health architecture, it was clear to the working group that financial resources are required as early as possible to contain a disease outbreak and prevent it from turning into a pandemic.

Indirect, index-based insurance presents an interesting option in this respect, the experts agreed. Whereas indirect insurance against natural hazards has been tried and tested, indirect insurance against disease outbreaks is still very much in its infancy. Two approaches are currently under development: the World Bank's Pandemic Emergency Facility (PEF) – expected to become operational in 2017 – and, following a request from AU Ministers of Finance, the African Risk Capacity's Outbreak and Epidemic Insurance.

As for any index-based product, the availability of timely and reliable data related to the pathogens to be covered is an essential precondition for indirect insurance against disease outbreaks. This precludes insurance against *unknown* pathogens which can only be covered through complementary financing mechanisms.

Important criteria for the selection of pathogens against which to obtain insurance also include the potential severity and frequency of outbreaks they may cause; i.e., endemic diseases in a particular region would typically not be covered by outbreak insurance.

To ensure that an insurance payout is used effectively it is indispensable to have flexible contingency plans in place which clearly assign roles and responsibilities in the case of an outbreak, the working group recommended. At national, regional as well as global level the necessary capacities to contain disease outbreaks need to be created and maintained. Through the necessity to prepare as well as the requirement to invest in data quality and reporting indirect insurance against disease outbreaks contributes to health system strengthening. If insurance premiums are risk-based this effect may be further enhanced by a financial incentive.

With respect to the public goods character of global health security the working group stated that a number of issues in the area of outbreak insurance merit further consideration: e.g. how should failed states be dealt with? How can moral hazard – i.e. an incentive to underinvest in preparedness at national level – be avoided? Who should pay for outbreak insurance coverage – national governments, international development partners?

Climate indirect – insuring governments and intermediaries

The working group climate indirect also discussed the limits of insurance as well as possibilities of how to achieve insurance for all.

The impact of indirect climate insurance is influenced by a variety of preconditions. Having access to reliable data was identified as the most important prerequisite for obtaining insurance coverage, as accurate, timely and historical data is the foundation of a consistent model for adequate climate insurance pricing. Furthermore, political will and commitment by the government or intermediary to use own financial and human resources for the implementation of insurance are necessary. This is much easier to achieve if the benefits and costs of climate insurance in comparison to not acting or acting differently can be communicated to the stakeholders. Besides that, the responsible entity has to have the financial resources available to pay the premium as well as a supporting legal and regulatory framework.


Esther Baur (Swiss Re) visualises Swiss Re's reinsurance approach in Latin America for the participants of the working group climate indirect

Regarding the role of climate insurance as part of managing disaster response it was clearly stated that any form of insurance alone is no panacea but needs to be combined with prevention and mitigation measures.

A proper contingency planning and risk assessment prior to any natural disaster is essential in order to know who and what will be insured and who will implement the subsequent disaster response. Coverage and purpose of the insurance should be well-communicated to the stakeholders. An often neglected issue is the last-mile-problem of how the premiums will reach the population in case of a disbursement. Governments and intermediaries have to take this into account.

A vivid discussion focused on how to make insurance premiums affordable, starting with whose perspective of affordability should be considered. Of course product design and delivery are essential for cost containment and a low-budget insurance product. Competition in the insurance sector additionally helps reduce premiums, although companies still have to receive their appropriate risk margin for the system to work. The financial capacity and literacy of the ultimate recipient and premium payer should definitely be considered in the process of product design. Combined with an appropriate expectation management it has to be assured that there is a common understanding of what should be insured and how much that would cost. Insecure data raises risk sensitivity and therefore investment into high-quality data collection is unavoidable.

In order to design an appropriate insurance product all relevant stakeholders have to be included in the process. Creating feedback loops and complaint mechanisms for the ones involved not just in the design phase but also during contingency planning is just as relevant as ensuring one can track the cash flows of the climate insurance system.

Cross-sectoral Exchange

One of the main intentions of this event was to provide a platform for a cross-sectoral exchange in order to profit from the other sectors' experiences. Overall it might seem to be difficult to compare the two sectors, health and climate, as they followed different goals and used different risk management tools throughout the past decades. However, the Development Finance Forum showed that both sectors share certain similarities and challenges that can be addressed by learning from each other.

Direct: cross-sectoral conclusions and recommendations

The introduction of mandatory schemes was one of the main discussion points of the cross-sectoral exchange on direct insurance approaches. More precisely, the participants shared the opinion that mandatory insurances as well as schemes that profit from governmental subsidies, should be specifically subject to a well-functioning regulatory framework and adequate products. Setting these standards is the responsibility of the national governments. Donors can play a rather supportive role if the governments lack the necessary know-how.

Markus Loewe (German Development Institute) explains lessons learnt of the exchange between direct health and climate insurance approaches

Another important aspect is the adherence to the guiding SDG principle *leaving no one behind*; an aspect which is already covered by the health sector and yet to be tackled by the climate sector. In order to reach the poor it is essential to design appropriate incentives for all stakeholders involved and especially for the beneficiaries. If done properly, this could eventually contribute to the goal of providing universal health or even universal climate coverage.

Furthermore the issue of bundling insurance approaches with other products was raised. Despite the fact that bundling is fairly new in the health sector, it might be a promising solution for advanced health care products (for instance to make up for lost income when being hospitalised). In that regard, the health sector can benefit from lessons learned of the climate sector, as bundling products are already widespread in the area of direct climate insurance. The challenge, however, is to keep the costs for a combined service package low. This holds true for both climate and health insurances.

In general, the participants of the direct insurance working groups agreed on the importance of a well-developed administrative infrastructure, adequate delivery systems and high quality service products. This includes the involvement of the private sector. Reinsurance providers, for instance, can potentially increase the quality of product design and delivery by integrating their know-how.

Indirect: cross-sectoral conclusions and recommendations

Saadia Madsbjerg (The Rockefeller Foundation) presents the results of the indirect cross-sectoral learning process

The main message of the discussions in the indirect working groups was the common belief that insurance is only one tool of risk management solutions. In order to safeguard especially the poorest and most vulnerable from climate and health risks, a holistic approach with both ex ante and ex post measures is essential. In other words: preparedness is key in order to mitigate risks.

Due to the fact that insurance schemes are a rather new product in international development cooperation, one has to keep in mind that this is a learning process, meaning that there are still challenges to face and adaptations to consider. In a holistic approach, governments, the private sector and donors have to work together. Especially the private sector including reinsurance companies hold a high potential in providing know-how and make longer-term investments. In that regard, it is important to get incentives right for prevention and mitigation measures.

Similar to the discussions in the direct working groups, priority is given to the goal of *leaving no one behind*. This claim is only feasible if governments provide for regulatory frameworks that focus on protecting the poor and vulnerable. One aspect of reaching everyone is to build capacities and spread an understanding of insurance approaches on all levels – especially on the beneficiary level. This includes the challenge of building trust amongst the stakeholders involved, which will take time and resources.

Sufficient information, adequate data, relevant triggers and transparency are the main preconditions of a well-functioning insurance system. Furthermore, reaching the last mile is not only a financial but also a political issue. Health and climate policies as well as social protection schemes are needed to make sure to include even the financially constrained.

On a broader level, indirect insurance is a valuable instrument not only to share financial losses within a country but also between rich and poor countries. Thereby, risks can be mitigated in the long run. An international response facility, if established, would benefit those countries that are not able to establish an adequate system on their own.

Conclusions

During the two-day conference a number of concluding aspects emerged. Since insurance is neither the only solution nor a guaranteed success – “no silver bullet” - it has to fulfill a number of criteria if it is to be included in development cooperation on a larger scale:

1. **Good products:** Insurance products have to be adapted to the specific needs and at the same time be simple and transparent in order to contribute substantially to the achievement of the SDGs.
2. **Trust:** There needs to be a great level of trust if insurance is to thrive - between partners and stakeholders, but also between insurance providers and clients.
3. **Cooperation:** Better collaboration between the public and the private sector is needed, crowding in the expertise and the experience of the insurance industry.
4. **Funding:** Insurance for the poor needs some kind of subsidy. But how much is adequate and how much is too much?
5. **Safeguards:** A regulatory framework is necessary to protect customers – and at the same time building up trust. “We need responsible insurance”, said one panel member, “just as we need responsible finance”.
6. **Communication:** Insurance has to be well understood, conveyed and implemented. Communication and education have to be solidly built in order to remove several misconceptions or psychological barriers: people and countries, especially those with real (financial) constraints tend to view insurance as a luxury item with little tangible benefits. When money gets tight people rather do without this kind of risk prevention, especially because the matter is complex. And then there is the psychological barrier that it seems to be difficult to take care of something that might never occur. For all these reasons communication is key. Or as one participant put it: “There is a huge underestimation as to how much education we have to get on the ground.”

In the end it melts down to the aspiration of spreading insurance as quickly and broadly as possible and at the same time doing it in a responsible and sensible manner. This conflict of goals has to be managed in a generally favorable and insurance-friendly political setting.

Stephan Opitz from KfW said at the end of two very productive and intense days: “The commitment is there, the will is there, the spirit is there. But the search for the best solutions has just started.”

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