



Working Session on Risk Transfer and Insurance for Resilience ISSUE BRIEF

I. Stock taking

Significant protection gaps remain, particularly in highly vulnerable regions, and the world has agreed that now is the time for integrated, collaborative action to mitigate the risks and to reduce poverty, hunger, inequality and the worst impacts of climate change by 2030. Transformative actions can be taken now to demonstrate foundational progress before 2020.

Meanwhile risks accumulate as the majority of investments globally are not risk-sensitive. Global capital formation and population redistribution into dense urban environments in low-lying coastal zones are one of the most visible examples. The pervasive practice of financing after disaster, rather than integrated risk financing in advance of a hazard event, and restricted commercial use of data and risk modeling cannot keep pace with the accumulation of risks in both higher and lower income countries. This practice is propelled by political and policy decisions, perceived economic priorities and a lack of risk awareness. There is however a unique opportunity for action; through mobilizing, redirecting and unlocking the transformative power of trillions of dollars of private funding resources and expertise, to shift the paradigm from managing disasters to managing risk. Governments and industry must be ready to act as the impacts of disasters will affect societies' long-term economic growth and well-being.

Without this paradigm shift, it has been predicted that more of the world will become systemically uninsurable within the coming decades. Disaster insurance penetration remains alarmingly low – especially for those with the highest exposure. Over the past decade, only 2% of weather-related losses from natural catastrophes in lower middle and low-income countries were covered by insurance. The potential for this statistic to become a shared reality across all vulnerable regions of the world (whether low or high-income) necessitates longer range planning efforts that take this possibility into account, as the frequency, intensity and impacts of disasters continue to rise.

The universal agreements of 2015 are not a simple agenda, they are a bold agenda requiring new thinking and decisive, sustained, collaborative action. Sustainable risk-sensitive development demands a holistic, integrated approach, embracing three broad goals: social inclusion, environmental sustainability and economic development. The real significance of the universal agreements is the signal from, and for, Governments to plan at least a generation into our shared future. The focus of risk transfer and insurance must align with this new agenda and reconsider both the co-benefits and the multi-dimensional value created by availability and access to these mechanisms.

The 2030 Agenda for Sustainable Development, the Sendai Framework for Disaster Risk Reduction (Sendai Framework) and the Paris Agreement all identify the contribution risk transfer and insurance can make to increasing resilience and reducing the financial impacts of disasters, when integrated into broader disaster risk management strategies. The 2030 Agenda for Sustainable Development and the Sendai Framework have targets and indicators that provide new accountability mechanisms for the public and private sectors (including the re-/insurance industry) to articulate the benefits of their activities beyond the measure of GDP, income and other financial, economic indicators.



These new targets and indicators provide governments and industry with the opportunity to capture and assess the additional value derived from insurance mechanisms, namely, the building of societal confidence, and ultimately societal resilience and the regeneration of place-based ecological resilience. This will challenge the re-/insurance industry to not only maintain commercially viable modeling and risk transfer solutions, but to also use this expertise to engage in activities that add greater societal value; thereby supporting the broader goals of these agreements.

An integrated approach implicitly suggests that a new wave of collaboration and co-creation of solutions is possible and will be beneficial. Sustainable Development Goal 17 explicitly states that “a successful, sustainable development agenda requires partnerships between central and local governments, the private sector, academia and civil society”. Paragraph 31(b) of the Sendai Framework calls for the promotion “of the development and strengthening of disaster risk transfer and sharing mechanisms and instruments in close cooperation with partners in the international community, business, international financial institutions and other relevant stakeholders”. Public and private entities, including risk modelers and global associations, can work together to explore and address innovative solutions to the challenge of increasing societal resilience. Since the 2015 World Conference on Disaster Risk Reduction in Sendai, collaborative mechanisms such as the Insurance Development Forum (IDF) have created important opportunities for dialogue, ideas exchange between disparate actors and the rapid co-creation and realization of novel solutions.

With the adoption of the New Urban Agenda in 2016 and the significant commitments of the Global Covenant of Mayors (amongst others) following COP21, efforts are re-focusing towards city-regions. The New Urban Agenda is premised on the notion that the battle for Sustainable Development will be won or lost in cities, with Governments committing to this paradigm shift in urban development “through strengthening governance, integrated urban and territorial planning and design and supporting effective, innovative, and sustainable financing frameworks and instruments”. Around \$90 trillion in new urban infrastructure investment is required to achieve the 2030 Agenda for Sustainable Development, this must be risk-sensitive and included in the consideration for new risk financing instruments and insurance mechanisms. The evidence is now clear that adopting an integrated, systems-approach to optimizing new infrastructure investment could reduce costs by up to 40%. In this context, it is essential to recognize that decisions made today will shape our urban risk-landscape for centuries to come.

The insurance industry’s core business is to understand, manage and carry risk, both in the short and the long term. The risk management process in insurance spans a continuum of activity—from identifying, assessing, preventing and reducing risk—to pricing, carrying and diversifying risk. Insurance operates through the public, private and mutual/ cooperative sectors and diverse risk financing/transfer techniques and schemes have been developed and practically implemented. Building on the insurance industry’s core skills and expertise, improvements in risk data availability and access, modeling and systems-approaches to policy and investment decision-making, articulation of the real value of insurance and collaborative approaches to solutions development and deployment, can all contribute to reducing the protection gap. The need for citizens in urban regions to be protected from existing and emerging risks has never been greater. There is an opportunity to increase risk literacy, or systems literacy, as part of broader efforts to improve risk visibility, educate vulnerable populations about the 2030 Agenda and shift efforts from ex-post response and recovery to ex-ante financing, management and prevention to achieve the ultimate goal of reducing disaster risk globally.



II. Overview

The insurance industry is uniquely placed within our societies, as a market mechanism for the sharing of risk. Without this mechanism to support the pooling of risk, risks would be borne solely by individuals, households, businesses, governments and other societal entities. However, the gaps continue to be significant between economic damage and insurance reimbursement; this is especially true in those countries with limited insurance penetration or limited insurance absorption capacity. Almost 70 % of the world's population is without access to adequate insurance solutions and the ability of these societies to prevent and mitigate future losses is severely hampered.

Given demographic and climate change trends, the level of insurance penetration is lowest where vulnerability is most acute. In developing economies, insurance penetration is essentially nonexistent for disasters. This scenario will worsen due to the rapidly destabilizing climate and increasing exposure from non-risk-sensitive investment and policy decision making.

Governments develop and implement the policy, regulatory and legal frameworks within which insurers operate and compete. Regulatory frameworks, incentives and public-private collaboration are also critical to providing vulnerable communities, particularly in developing countries, with access to risk management services and risk transfer solutions offered by insurers. Many of the more innovative policy and technical innovations in developing effective disaster insurance are being developed in low- and middle-income countries.

Effective risk transfer mechanisms are those that reflect the type and scale of risks to which each geospatial region is exposed, and the most effective mechanisms are those which align with risk reduction policies and societal objectives. In order to deliver appropriate solutions, there must be renewed focus on the significant role that public and private insurance can have in preventing or avoiding new risk, in reducing existing risk, and in strengthening social and economic resilience - for example, through conditional access to insurance, mandatory insurance and pricing incentives and rebalancing of asset and investment portfolios.

III. Way forward

With increasing strain on public resources to manage economic and social costs due to disasters, the adoption of the Sendai Framework and the 2030 Agenda, present an opportunity to revisit the social role and value of insurance. The investments in data collection and statistics that are a pre-requisite for monitoring progress through to 2030 also provide a unique opportunity for both increased accountability and a new way of articulating the value created by risk transfer and insurance activities in communities across the world. With the inclusion of risk transfer and insurance-related approaches for climate-resilient development in the Paris Agreement (which came into force in November 2016), both public and private actors need to engage in a broader societal discussion about the use of insurance and the role of the global insurance industry, including the wider value of risk modelling and data assets, in



partnership with governments and communities, in forging climate and disaster-resilient development pathways.

The range of measures available to further disaster risk reduction are diverse – from tailored regulatory measures, to stress tests for extreme events, to advanced integrated systems approaches to bringing forward risk-informed investment and policy interventions – and improvements are possible across the board. The regulatory framework in many countries for instance, can be enhanced such that the poorest can benefit disproportionately from early actions including reconsidering the value created by targeting the most vulnerable populations. Insurance solutions must make disaster and climate risk more transparent, and education and outreach must build risk literacy.

The progress made by the re-/insurance sector in evaluating risks (particularly those posed by extreme weather) has prompted calls for public and private sector organisations to be required to report their financial exposure to extreme weather at a minimum of 1 in 100 (1%) per year risk levels¹. Furthermore, the Task Force on Climate-related Financial Disclosure specifically identified the importance of improving the transparency and management of climate-related transition risks, beyond the more well understood physical risks, as a key area of opportunity for both financial and non-financial sector actors to minimize the potential for systemic shocks. Shocks which potentially cause significant financial and economic disruption, reversing hard won development gains.

Increased disaster risk poses a shared, global risk, necessitating shared action. The interdependencies in the relationships between the insurance industry, risk modellers, governments, businesses and society are a strong incentive for collaboration. Collaboration must now occur at scale, in all geographies, at each step of the insurance risk management value chain, including: risk identification and analysis; risk prevention and reduction; and risk transfer.

IV. Key Areas for Action

a. Risk identification and Analysis

Public authorities and insurance providers can collaborate to review and understand the risk landscape by improving the availability, reliability and accessibility of disaster risk data, including the development of loss models. This will enhance risk prevention and risk reduction measures and risk transfer products. Risk analysis should give consideration to how risks interact and how to deal with uncertain future risks.

Risk identification, data collection and risk analysis are at the core of risk management approaches. The data gathered through insurance risk assessments can catalyse the establishment of data repositories, while the insurance industry drives the standardisation of gathered data to improve regional and international analysis. Publicly collected, open-source data and open-source hazard modelling can contribute meaningfully to national and regional risk management and investment decisions.

¹ The Royal Society. 2014: "Resilience to Extreme Weather" November, London



b. Risk Prevention and Reduction

Risk prevention and reduction can be supported and encouraged through measures that may include: land use, planning and management (including zoning); infrastructure safety and resilience (including the enhancement and enforcement of building codes); and the management, conservation and restoration of natural ecosystems (e.g. mangroves, wetlands, sand dunes) to reduce disaster risk.

Prevention and avoidance of new risk creation can be incentivised in many ways that the re-/insurance industry can consider, including but not restricted to: consideration of the timeframe of insurance coverage for long-term risk; making the issuance or renewal of insurance cover dependent on risk prevention and reduction measures; and pricing risks closer to actuarially sound rates (providing a better indication of the nature and level of the risk).

Recognising that the complete elimination of risk is unrealistic, and that residual risks will always remain – some of which can and must be transferred – it is in the interest of insurers to encourage policyholders to reduce their risk of loss. This reduces the likelihood of unexpected losses and the associated financial hardship, while allowing insurance companies to remain viable – this in turn makes insurance solutions more accessible and affordable in the future.

c. Risk Transfer

Public authorities and insurance providers can explore the development of integrated public, private or public-private risk management approaches and risk transfer solutions - embedded in broader efforts to increase resilience - within the context of policy, legal and regulatory frameworks.

Develop appropriate regulatory frameworks that improve the accessibility and affordability of a range of risk management tools, including insurance, particularly for low-income and vulnerable communities, and for low-emission power generation, transport, land-use, and energy efficiency projects.

Given the potential social and economic role, and value of insurance, the risk management expertise and resources of the global re-/insurance industry would be mobilised to help meet the challenge of building disaster-resilient communities and economies. This can be done effectively and efficiently by focusing action along the insurance risk management value chain, for instance to:

- Support the provision, co-ordination and standardisation of risk identification and analyses to facilitate the management of disaster risk, particularly supporting the availability, accessibility and quality of disaster risk data.
- Identify and develop incentives that will result in preventing and avoiding new risk, reducing existing risks, and embedding risk transfer in wider resilience-building efforts, ensuring alignment in policy and regulation.
- Facilitate, through insurance mechanisms, the provision of timely finance to reduce the financial repercussions of volatility related to disasters and ensure more timely and targeted delivery of support

Create proportionate regulatory arrangements recognizing mutuals, cooperatives, joint stock companies, etc. to encourage a risk management culture for low-income populations and promote consumer protection.



22-26 MAY, 2017 | CANCUN, MEXICO

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FROM COMMITMENT TO ACTION
