INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

access to insurance initiative

Climate risk insurance for the underserved and vulnerable: What is the role of insurance supervisors to foster its responsible development?

Report of the A2ii – IAIS Consultation Call

JAN 2020

The Consultation Calls are organised as a partnership between the Access to Insurance Initiative (A2ii) and the International Association of Insurance Supervisors (IAIS) to provide supervisors with a platform to exchange experiences and lessons learnt in expanding access to insurance.

Introduction

Climate change is increasing the severity and frequency of natural disasters, with low income and vulnerable segments of the population being the most affected. Insurance, as a piece of the disaster risk management puzzle, plays a vital role in building resilience and protecting individuals and communities against disasters. The regulatory and supervisory environment contributes greatly in enabling innovative ways and mechanisms to reduce the climate insurance protection gap. Supervisors are well-placed to stimulate action that can strengthen resilience and reduce the protection gap with respect to climate risks.

The input on this call was based on an interactive dialogue between practitioners and supervisors. The dialogue was based on a series of questions (see below). Mathieu Dubreuil from the World Food Programme (WFP) and Paula Pagniez from the Willis Towers Watson (WTS) shared their perspective as practitioners in the insurance sector. Luc Noubissi and Cedric Miakwang from the Inter African Conference for Insurance Markets *(Conférence Interafricaine des Marches d'Assurance – CIMA)* contributed to the discussion by sharing their supervisory views during the French and English calls respectively. Whereas, Rafael Cestero (Oficina del Comisionado de Seguros, Puerto Rico) was the contributor duringthe Spanish call. All the sessions were moderated by Andrea Camargo (director of Inspowering and technical expert of the A2ii).

Brief overview: A2ii's thematic report on the role of supervisors in climate risk insurance

This call largely drew on A2ii's own thematic report on "The role of insurance supervisors in climate risk insurance"[1] . The paper provides a fresh perspective on the role of supervisors in reducing the insurance protection gap in respect of climate risks. In the report, the term "climate risk" encompasses natural disasters that affect vulnerable households, entrepreneurs, smallholder farmers, whether amplified or not by climate change. The report also highlights that insurers can play a crucial role in building resilience of low-income and underserved populations against climate risks. However, they face a variety of obstacles (see figure 1) as highlighted from a 2019 survey carried out by the A2ii to explore the obstacles that practitioners face when designing and implementing solutions to manage climate risks and natural disasters:

1 Available at: https://a2ii.org/en/media/2536/download

OBSTACLES FACED BY THE INDUSTRY TO INNOVATE ON CLIMATE RISK INSURANCE

POLICY LEVEL

- CRI is not recognised as a key component to achieve public policy goals
- There is no coordination amongst policymakers to promote CRI
- There is a lack of understanding of the business case of CRI and a lack of incentives to make products sustainable and scalable

REGULATION

Not allowance of:

- index insurance
- alternative distribution channels
- electronic signature, payments and contracts

- Restrictions to reinsurance transactions
- A wide range of taxes
- CRI is not mandatory
- Slow acceptance to technology innovations

SUPERVISION

- Supervisors are unaware of the role that they can play in order to promote resilience against climate risks and natural disasters
- Supervisors are reactive and not proactive, they impose barriers to product approval
- Supervisors are not open to innovation
- Supervisors do not have the technical skills to understand the complexities of new approaches
- Capacity building to supervisors is expensive and time consuming

DEMAND

- The vulnerable populations are not aware of CRI
- Lack of understanding of the risks that the vulnerable populations confront
- Sometimes consumer centric approaches for product design are not adopted
- Lack of incentives for CRI takeup
- Lack of support of governments to raise awareness on CRI

SUPPLY

- Limited support to the industry during process design
- Lack of data and access to data
- Lack of local capacity for product design that is matched by complications for reinsurers to provide capacity building
- Limited room for innovative business models
- Technology could be expensive and not allowed
- Lack of incentives

Figure 1: Obstacles to CRI according to the industry

The report highlights that supervisors are well-placed to catalyse action to strengthen resilience against climate risks, particularly via two pathways:

- Firstly, developing the market by stimulating supply and demand of valuable and responsible climate insurance solutions.
- Secondly, by promoting the spread and adoption of climate risk management understanding and practices internally as well as among critical stakeholders, including by actively harnessing the role and expertise of the insurance industry as risk experts.

Synthesis of the supervisory-practitioner dialogue

The following section, up until the questions and discussions, is a synthesis of the key points from the supervisory-practitioner dialogue that took place during the calls.

What can supervisors do in order to encourage the development of responsible climate risk insurance markets?

Supervisors have within their means the ability to set up proper frameworks and mechanisms to enable the development of responsible markets. During the call, the following examples were shared:

- **Setting up coinsurance pools to unlock opportunities for specialised insurers.** The creation of coinsurance pools can unlock opportunities for the development of CRI products especially in countries where the insurer does not have the capacity to offer CRI. The supervisor can play an instrumental role in driving such initiatives.
  - In Senegal, the insurance supervision department championed the creation of the CNAAS[2], a specialised agriculture insurance entity that brings together private and public insurers to provide agriculture insurance products to smallholder farmers.
  - In Malawi, there is a weather-based index crop insurance pool for agricultural insurance.[3]
  - The CIMA code (Book VII)[4] allows specialised microinsurers to specifically provide climate risk insurance products.

- **Taking steps to enable affordability**[5]. Supervisors are in a position where they can engage with policymakers on tax requirements e.g. exemptions or reducing taxes and fees for insurance products that cover climate risks and natural disasters. For instance:
  - In Nicaragua, agricultural insurance is exempt from VAT.

2 Compagnie Nationale d'Assurance Agricole du Sénégal

3 See more examples in (Mahul & Stutley , 2010) available at: https://openknowledge.worldbank.org/bitstream/handle/10986/2432/538810PUB0Gove101Official0Use0Only1.pdf?sequence=1

4 Available at: http://www.dna.finances.gouv.sn/legislation/code_cima2019.pdf

5 See A2ii survey in pg. 22 of A2ii's thematic report

- In Malaysia, as a result of annual budget proposals by the regulator to the Ministry of Finance, inclusive insurance products were made exempt from stamp duty in 2018.
- In Senegal, the supervisor led the dialogue with the Ministry of Agriculture, to allow tax exemptions for agricultural and livestock insurance products. The supervisory authority in Senegal was also instrumental in leading discussions regarding the introduction of subsidies for agricultural insurance products targeted to smallholder farmers.

- **The option to test new innovations.** It is important for supervisors to adopt proportionate supervisory approaches that allow the industry to pioneer innovative ideas. The injection of innovative ideas into the market rests on the industry's ability to test new ideas beyond the tried-and-tested models, learn from mistakes, find solutions that work, and eventually offer them on a sustainable basis. Some of the ways include:
  - **The piloting of innovative products.** Supervisors can encourage pilot initiatives. For example, in the CIMA zone, CNAAS piloted an agricultural insurance project in Senegal that provided guarantees to cover climatic risks. CNAAS was set up specifically to protect rural populations against climate risks. In El Salvador, Guatemala, Kenya, and other countries, supervisors have allowed index insurance pilots to take place despite lack of a specific regulation on index insurance at that time. The experience and evidence gained from the pilots guided and catalysed the eventual enacting of such regulations in some jurisdictions.
  - **Regulatory sandboxes** initiatives that can allow practitioners to innovate in a structured and contained way, that ensures a level of consumer protection.

- **Collaborating with the government.** Supervisors can provide advice on the legal, regulatory and financial considerations for the government's involvement in climate risk insurance initiatives. Supervisors have a mandate for technical assistance vis-à-vis the government in the event of a catastrophe. For instance, following a land slide in Cameroon in October 2019, (causing 43 deaths and destruction of property), the supervisor lobbied the government to anticipate and prevent potential future losses through joining initiatives such as the African Risk Capacity (ARC) which acts like a sovereign risk pool for governments to better plan, prepare, and respond to extreme weather events and natural disasters.

- **Enabling a variety of distribution channels.** Some of the ways to foster innovative distribution strategies for CRI products include:
  - The ability to leverage on a wide range of aggregators and transactional platforms for instance microfinance institutions (MFIs), cooperatives, Community Based Organisations (CBOs), agribusinesses, among others.
  - Digitalisation of the insurance value chain. Technology plays a vital role in innovative CRI products such as index insurance schemes, where advanced modelling is required to design reliable indexes and remote sensing is key to ensure scale. Technology is also required to geo-localise communicate and enrol clients as well as collect premiums and issue payouts.

What can supervisors do in order to ensure that the insurance industry can share their risk management expertise for the benefit of the society and make it more resilient?

The insurance industry is keen to expand its role in building disaster resilience, but it has identified various obstacles. These obstacles relate to policy, regulation and supervision, as well as market demand and supply factors. The industry is able to integrate into their business models' ways to offer, incentivise or encourage the adoption of comprehensive disaster risk reduction approaches. During the call, the following approaches was highlighted:

- **Raise awareness** to ensure that insurance is understood and integrated into a broader risk management strategy.

- **Enable platforms to ensure that everyone sees the potential role that the industry can play to improve understanding risk in the country.** As practitioners in risk management, the insurance industry plays a key role in ensuring that risk is understood in contexts where climatic events are more frequent and severe and where these events are becoming "uninsurable". During the call, the WTW highlighted the importance of understanding risk and identifying the level of vulnerability of communities. Consumers need to receive guidance in terms of their risk exposure and on how they can manage risk. The industry can support this process. The WTW recently launched a Climate Quantify initiative platform[6] that supports governments, financial institutions, businesses, investors, farmers, among others to better assess their risk and understand how to manage it.

- **Explore ways to encourage the adoption of Disaster Risk Reduction (DRR) and Climate Change Adaption (CCA) measures.** For instance, the introduction of loans for premiums that are provided to those who adopt measures to reduce risk and improve resilience.

- Consider that the insurance industry is an **institutional investor** that could promote the investment in assets that could build resilience. As institutional investors, insurers could contribute towards DRR and CCA, through firstly, directly investing in investments that enhance climate resilience and adaptation and secondly actively reduce their carbon investment footprint.

- **Monitor closely the implementation of CRI solutions.** The supervisor can evaluate experiences on the ground in order to identify good practices. Reporting obligations can help in this context. The supervisor can define which information is needed to identify good/bad practices.

6 See https://www.willistowerswatson.com/en-GB/Insights/trending-topics/climate-risk-and-resilience

What can supervisors do in order to support policymakers and other governmental entities to ensure that insurance is seen as a piece of the puzzle of disaster risk management?

Supervisors are in a unique position to advocate the importance of disaster risk management, amongst policy makers and stakeholders in the insurance industry. Some of the ways that supervisors can contribute to national policy decisions around CRI, include:

- **Engage in dialogue.** Supervisors are in a position to engage with policymakers on key issues such astax requirements and subsidies for insurance products against climate risks and natural disasters.

- **Create awareness** among policy makers to ensure that insurance is seen as a key part of the DRR puzzle and how it can contribute to other policy goals.

- Ensure that stakeholders focus on the quality of CRI products, instead of focusing on competition only.

In closing, supervisors and practitioners on the call shared the following wish list:

- **Active participation in capacity building activities.** Supervisors need to be equipped with expert knowledge. Participation in international capacity building events on CRI and disaster risk management generally can help supervisors gain exposure on best practices in other jurisdictions.

- **Enable innovation** for CRI products, business models, distribution channels, while at the same time ensure consumer protection to promote responsible and sustainable CRI markets.

- **Closer engagement between practitioners and supervisors is key.** Supervisors can draw on the wider role of the insurance industry as risk management experts. At the same time supervisors can have intimate knowledge of the technical capabilities of insurers, given they supervise them and approve new CRI products.

- **Strong collaboration and engagement with the government,** especially in disaster risk financing strategies to ensure that they recognise insurance as a piece of the puzzle of climate risk management.

Questions and Discussion

With respect to mortgage insurance, should the insurance supervisor encourage wider scope of risk coverage including the CAT ("catastrophic") risks? There are traditional insurance products that are providing coverage against natural catastrophes and risks. On traditional property insurance products, the A2ii thematic report highlights the potential of traditional property insurance products. Besides specific innovative CRI for the unserved and underserved, traditional property insurance products that are available in the market also offer an opportunity for wider coverage. These products could be accessible to the generally unserved and underserved population, by being linked with mortgages in the context of social housing projects, or could be provided as business coverage to small and micro entrepreneurs or smallholder farmers.

Are there any rules or customer protection requirements to govern bundling or packaged products (especially tied together with non-financial products like seed inputs, fertilisers)? Bundling can increase the demand and awareness for insurance, but also comes with consumer protection risks. However, bundling may be a necessary practice in CRI. Indeed, 90% of the index insurance products mapped by the Syngenta foundation are bundled with loans, agricultural inputs or the provision of valuable information to clients, such as weather and price information[7]. In accordance with ICP 19 the supervisor requires insurers to promote products and services in a manner that is clear, fair and not misleading and to set requirements for insurers with regard to the timing, delivery, and content of information provided to customers at point of sale.

What would be the risks involved in using electronic signatures? The main risks relate to fraud, forgery and the failure of the technological platforms to support electronic signature processes.

What can be done to ensure access to insurance especially for rural populations? Unlocking innovative distribution channels and enabling digital platforms can be two remaining barriers to overcome. However, it is important to ensure that consumers are linked with a trusted partner that can guide them and solve their queries, especially for business models that require intensive consumer interaction.

Is bundling or mandatory cover, the most feasible model to gain scale for climate risk insurance? Voluntary insurance offered by private sector may be challenging to gain scale due to low awareness and lack affordability (without subsidy). Most of the index insurance products in the agriculture sector are bundled with loans, inputs, etc. The most successful business models are models where the insurance product is bundled or mandatory. However, in using these models, consumer protection should be ensured i.e if an insurance product is bundled or mandatory, consumers should receive comprehensive information about the product, its benefits and how to use it. They should be given the choice of selecting providers and treated fairly at all stages of the insurance value chain.

7 See pg. 34 of A2ii thematic report: https://a2ii.org/en/media/2536/download

Implementation Partner:

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Supported by:

Federal Ministry for Economic Cooperation and Development

Ministry of Foreign Affairs of the Netherlands

Hosted by:

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

Access to Insurance Initiative
Hosted by GIZ Sector Project
Financial Systems Approaches to Insurance
Deutsche Gesellschaft für Internationale
Zusammenarbeit (GIZ) GmbH
Dag-Hammarskjöld-Weg 1-5
65760 Eschborn, Germany

Telephone: +49 61 96 79-1362
Fax: +49 61 96 79-80 1362
E-mail: secretariat@a2ii.org
Internet: www.a2ii.org

a2ii_org

Promoting access to responsible, inclusive insurance for all.