



Focus Group: Risk

Vulnerable Twenty (V20) Group of Ministers of Finance

V20 VIEWPOINT

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I. Rationales and Objectives for Premium and Capital Support and the V20's Strategic Interest in Its' Transparent, Accountable and International Provision:

1. While high-income countries have suffered the highest nat-cat losses in absolute terms, climate-vulnerable lower income countries such as the V20 have sustained losses that are three to four times larger when compared to the affected share of the economy or population. The relatively higher damage to GDP ratio, in turn, affects near- and long-term economic growth and development.
2. The imperative of responding to climate change losses and adaptation finance needs in vulnerable countries calls for substantially scaling up investment in risk financing instruments that build both resilience and reduces debt without compromising the fiscal space for crucial social and economic spending. Current budgets, however, fall short of what is needed to reduce life and economic losses. Climate and Disaster Risk Finance and Insurance (CDRFI) can support the managing down of risks and utilization of opportunities. Without the accessibility and affordability of financial tools, however, the lives lost and the financial and operational fall-out in climate vulnerable countries could undermine and reverse the development gains achieved so far.
3. Providing **concessional financing e.g., through premium and capital support (PCS), specifically in the context of climate and disaster risk insurance (CDRI)**, is now being discussed globally as an important tool to enable and encourage the use of CDRFI by directly or indirectly reducing the costs to beneficiaries. Given the **current fragmentation and rather arbitrary, ad-hoc and non-transparent provision of PCS** to individual pools, governments and insurance schemes, **the development of a reliable, rules-based provision of PCS and a coordinated and transparent delivery structure is key to increase the uptake of CDRFI in light of constrained financial resources and competing development priorities.**
4. Broadly speaking, several forms of financial support through PCS, including concessional credit and grants, can be considered to enhance the application of CDRFI. Looking across the entire spectrum of CDRFI instruments, **PCS should include measures to reduce the costs of insurance products, such as directly financing the insurance premium through premium subsidies, as well as indirectly subsidizing the insurance products by providing capital necessary for**

product development, marketing and distribution or capitalizing risk carriers e.g., regional and (sub-)national risk pools or market-based structures such as the Natural Disaster Fund, **to support operating costs or contribute to the carrier's risk capital**. Capital support can also be provided for insurers operating at the micro or meso levels, for example through **debt- or equity investments for local insurance companies**, as is the mandate of the InsuResilience Investment Fund.

5. In the context of other CDRFI instruments such as e.g., contingent credit lines, capital support can be introduced to further reduce the cost of capital, that is, loan interest payments. Moreover, when considering CDRFI instruments for risk retention or self-insurance, capital support can also include measures that finance the capitalization of (national) emergency funds. One example in this regard is provided by the US and the Marshall Islands: Marshallese contributions to the Disaster Assistance Emergency Fund are matched, one to one, by the US government.
6. Focusing on insurance in V20 economies, it should be noted that despite increasing economic damages due to natural hazards, **uninsured losses constitute a major portion of disaster damages in many V20 countries, pointing towards the large insurance protection gap** among low- and middle-income economies **and missing or nascent disaster risk markets on the micro, meso and macro level**. While underinsurance arises due to several demand side and supply side conditions, affordability and competing development priorities in the context of constrained resources are the prime justification, particularly for lower-income households, micro, small and medium-sized enterprises (MSMEs), and governments.
7. In the context of building (national) CDRI markets, social safety nets and access to national and sub-national sovereign insurance solutions to address climate risk, PCS can be defined as *any form of financial support or provision of concessional finance (inclusive of grant finance) to reduce the insurance premium either directly or indirectly through capital support for the risk carriers*. It should also be noted that PCS is understood to play a critical role in addressing both, market inefficiencies and inequitable coverage to overcome demand and supply side challenges. As such, it can contribute to creating new insurance markets, increase insurance penetration rates, provide funding and liquidity for CDRI products, and build financial resilience.
8. Furthermore, for many V20 countries the disaster risk insurance market is new and emerging, which makes it highly likely that the insurance market suffers from various inefficiencies such as asymmetries of information, externalities, and high fixed costs of operation. Therefore, it will usually be more effective to first or at least simultaneously invest in addressing inefficiencies in insurance markets, specifically through various forms of capital support, before considering traditional, direct premium subsidies.
9. Climate vulnerable countries require shared leadership and collaboration at the global level to survive and thrive with a loss multiplier subject to climate and disaster risks, currently and in the future. As such, the **V20's strategic interest in**

PCS is supported by the intent to reduce loss to life, protect fiscal space, reduce external debt distress and promote economic growth in the context of climate change through increasing the affordability of CDRI, develop new disaster risk markets and boost demand, and promote higher insurance penetration.

10. To achieve this objective, the V20 can support **a principled approach to the international provision of PCS in line with individual economic, market and macro-fiscal conditions, and built on a coordinated, transparent and cost-effective international PCS delivery structure** through better alignment of the institutions and instruments that make up the current international CDRFI architecture.

II. Towards a Rules-Based Approach: Smart Principles for Premium and Capital Support

1. Generally, one can differentiate two types of PCS: **(1) Market-accelerating PCS to kick-start and accelerate the formation of risk markets and the required infrastructure**, such as data collection and management systems, catastrophe risk models, or climate risk and financial literacy, and insurance product uptake. For example, at the macro scale, subsidized risk capital, such as the capitalization of catastrophe (re)insurance pools, can contribute to enhancing competitive insurance markets and creating new business opportunities for the financial markets by reducing the cost of capital. On the micro and meso scale, subsidized risk capital in the form of equity or debt investments for local insurers can furthermore support product development costs, the building of distribution networks or the insurers' underwriting capacity, thereby also lowering the cost for reinsurance. **(2) Social protection premium and capital support for social safety nets to extend insurance to the most underserved population segments.** In cases where insurance markets are lacking and low income and vulnerable households are the target group, PCS for social insurance can be used as a part of broader safety net to insure the most vulnerable population who would otherwise not purchase insurance. Usually, social premium subsidies come in the form of subsidies fully or partially equivalent to the insurance premium. In the context of micro level CDRI, social subsidies are well-known in the context of agricultural insurance schemes or livelihood programmes and are provided as a part of annual government budget allocations. Recent examples also include social subsidies in the context of CDRI schemes that link the macro to the micro level e.g., the COAST Facility of CCRIF-SPC within which participating Caribbean governments purchase the provided CDRI product designed to protect national fisherfolk, but channel potential payouts directly to pre-defined beneficiaries in the fishing sector.
2. Working to support the objectives of improved affordability, enhanced insurance penetration and the creation of new markets either through market-accelerating PCS or social PCS at the micro, meso or macro levels, five core principles can be defined for application by G20 and V20 governments as well as development partners part of the InsuResilience Global Partnership and beyond.

Principle 1: (S) Sustainability - Clear entry and phase out strategy based on the needs of the recipient

- The supported CDRI instruments should demonstrate maximum value for money to generate willingness to pay over time.
- The PCS measure should be based on the needs and priority of the recipients.
- Financial trade-offs for different forms of PCS should be considered.
- The decision-making on PCS should not only consider the interplay of PCS with other, more indirect measures such as risk reduction and resilience investments, but also the trade-offs between using scarce public resources either for risk reduction and adaptation investments or PCS.
- The PCS measure is based on clearly formulated objectives and includes entry and phase out strategies
- The PCS measure should create added value for all stakeholders: insurers, delivery channels, governments, and donors.

Principle 2: (M) Market-building - Higher penetration and coverage

- PCS measures should incentivize new disaster insurance markets by increasing the capacity of the recipient to subscribe to disaster insurance and by including new population segments.
- PCS measures should support partnerships between the public sector and private insurance market players and incentivize the creation of enabling conditions for market-building to offset the share of government contingent liability.

Principle 3: (A) Affordability, Availability and Accessibility - Sufficiently inexpensive and available

- The PCS instruments available for the specific range of risk transfer products existing in a particular market should reflect the country's disaster risk landscape and social and economic context.
- PCS interventions should aim to expand the range of available products suitable for households, specifically from lower income segments, MSMEs and sovereigns.
- Premium *and* capital support are no substitutes for each other. Depending on individual cases, a combination of *both* may be needed to increase affordability, availability and accessibility.

Principle 4: (R) Resilience Building - Better risk management and risk reduction

- PCS interventions should aim to contribute to comprehensive disaster risk management practices built on a risk layering approach¹ and thus be realized as part of a comprehensive financial protection strategy that mobilizes different instruments.

¹ Consists of a mix of self-insurance through fiscal buffers; (ii) transferring risk through insurance or other risk-sharing mechanisms at the micro, meso and macro levels ; (iii) arranging contingent financing via pre-arranged credit lines with international financial organizations (iv) reliance on concessional financing and humanitarian assistance from the international community when risk transfer is not cost effective for very large and rare disasters.

- PCS interventions should be designed to incentivize complementary action and investment in risk reduction, such as hard and soft engineering in the context of structural measures and legislative interventions such as building and settlement codes in the context of non-structural measures, in line with a risk-layering approach as well as prevent inefficient outcomes within the insurance industry, that is overinvestment in risky and damaging activities by individuals, households or businesses.
- PCS interventions should ensure to not undermine efficient outcomes within the insurance industry and thus not incentivize overinvestment in risky and damaging activities.
- The provision of PCS needs to be flexible to adjust sufficiently to the changing current and future climate risks and depending on the level of warming above pre-industrial levels by the 2030s.

Principle 5: (T) Transparency and Accountability - Unrestricted information on premium and capital support and payouts

- The performance of PCS should be evaluated based on the sharing of timely, relevant, adequate, and comprehensive information, so as to build evidence and learn in the medium and long-term.
- This also includes the sharing of information on payouts and verifiable information on losses on the ground, so as to increase understanding of the risks PCS recipients are exposed to; and promote support for CDRI instruments that improve risk management and value recognition of CDRI overall

III. For Sustainable Impact: Creating Enabling Conditions in V20 Countries

1. The above stated principles come with a variety of different implications for the different levels to which it is applied, i.e. the micro, meso or macro level, as well as with view to the responsibilities of the different stakeholders involved in PCS. While a more in-depth account is offered as part of the [MCII Background Note on Premium and Capital Support: Core Principles and Operational Indicators](#), and the [MCII Background Note on Premium and Capital Support](#), **V20 governments, recognizing that they themselves as well as international donors could assume the role of a PCS provider,² and based on the assumption that the necessary international support is available, should consider the following measures to ensure PCS, whether provided nationally or internationally, produces sustainable outcomes:**
 - **Principle 1 - Sustainability:** (a) Ensure the formulation of concrete subsidy objectives and enhance targeting techniques to establish a clear differentiation of low and higher income segments; (b) Develop a phase-out strategy and ensure systematic and actuarial pricing of premiums to ensure PCS interventions help the facilitation of risk markets and strive towards fully risk reflective premiums; (c)

² While some V20 governments may be able and willing to provide PCS as part of their own budget, given historical responsibility for climate change, the international community should provide PCS where willingness or ability to pay for insurance is constrained by objectively reasonable barriers e.g., competing development capacities, lack of financial capacity, intensifying impact of accelerating climate risk, etc.

Assess the long-term sustainability benefits and life spans when differentiating between different instruments, such as capital support vs. direct premium-financing and the effectiveness implications of selecting specific recipients (e.g. the insured or the insurer); (d) Determine fiscal space and appropriateness of investment in PCS, dependent on simultaneous and complementary investment in risk reduction and preparedness; (e) Put in place plans for raising government revenue to ensure long-term viability and security of subsidy interventions.

- **Principle 2 - Market-building:** (a) Enhance regulatory environments to enable the development of high value-add products; (b) Consider how to effectively link risk reduction, behavioral shifts, and better access to financial services to disaster risk insurance interventions, including through the V20-led Sustainable Insurance Facility, as supported by PCS.
- **Principle 3 - Affordability, Availability and Accessibility:** (a) Contribute to improving current (sovereign) insurance products and other contingency instruments, benchmarked according to V20 needs and in line with a risk-layering approach, effectively combining different instruments at the micro, meso and macro level.
- **Principle 4 - Resilience Building:** (a) Mainstream climate resilience considerations into national budgeting and investment planning and develop comprehensive disaster risk management and finance strategies; (b) Incentivize and complementary to receiving international PCS, commit to risk reduction and preparedness investments and relevant legislative frameworks, aligned with the uptake and support of risk transfer solutions to enhance the cost-effectiveness of both; (c) Ascertain the quality of (national) insurance schemes to prevent moral hazard, maladaptation and rent-seeking behavior of private actors.
- **Principle 5: Transparency and Accountability:** (a) Build transparency around previous and recently provided PCS to determine best practice; (b) Show material country demand, by contributing transparent decision-making on the identification of national PCS needs and effectiveness of PCS execution; (c) Enhance the creation of national capacities for transparent tracking, measuring and evaluation of PCS; (d) Make available data and lessons learnt on the quality of currently existing insurance schemes; (d) Support the creation of unified data and reporting standards for measuring and evaluating PCS interventions.

IV. Key Elements to Determine V20 Requirements for Premium and Capital Support

1. In line with some of the specific requirements of the principles and building on the [MCII Background Note on Further Taxonomic Considerations of Premium and Capital Support and Allocation Aspects](#), the following key considerations should affect international decision-making on the allocation of PCS, its size and the time span for which it is provided. While much of the below account is focused on building national disaster insurance markets and further research is needed with view to how considerations related to allocation, amount and timespan differ in the context of supporting micro, meso or macro level instruments in *individual country*

contexts, it can serve as a first entry point for further engagement between the V20 and the donor community.

2. The below account is especially sensitive to the need to consider countries' overall fiscal and financial positions to access funds through loans, credits, and grants, which is further confounded by their climate vulnerability: Many countries that lack access to CDRFI are often highly vulnerable to climate impacts and also show weak public debt profiles, with negative implications for their capital costs. In the context of CDRI, market rate insurance premiums further limit many countries' scope to fully participate in insurance markets. To determine adequate levels of support, these considerations need to play a key role.
3. At the sovereign scale, CDRI solutions differ in terms of **pre-existing structural parameters relevant to the implementation of CDRI such as the stage of insurance market development, socio-economic parameters, physical risk parameters and fiscal parameters**. Taking this diversity into account is key to avoiding a one-size fits all approach for PCS interventions.
4. Based on country characteristics related to (1) Population and Geography³, (2) Economic and Debt Status⁴ and (3) Climate risks and Vulnerability⁶, three possible categories of countries eligible for the receipt of PCS can be identified:
5. **Category 1 - PCS for climate vulnerable countries or industries (Potential sustainable markets, with lack of willingness to pay)**: This category includes climate vulnerable MSMEs or countries with adequate fiscal space that are willing to recognize the value of financial protection e.g., through the integration of sovereign insurance in macro-fiscal decisions or business continuity and liquidity management (to protect from business interruption and maintain credit access). Countries (or MSMEs) in this category are mostly under no high debt stress and

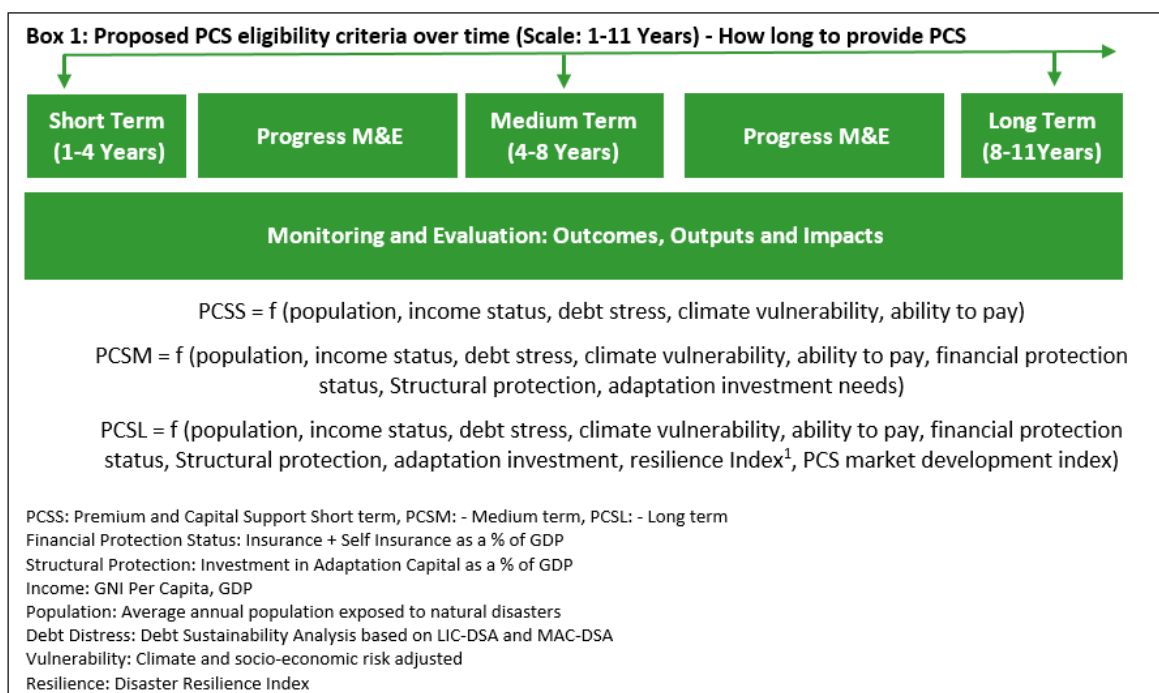
³ Population and geography of a country play an important role in defining the capacity to absorb and respond to disaster risk. For example, most low-lying islands with small populations comprise a heterogeneous group but share many similar characteristics and vulnerabilities which pose challenges for development and macroeconomic stability. Due to their small population and economic size, they have narrow production and export bases as well smaller insurance and underdeveloped capital markets as compared to countries with large populations and less remote geographic locations. Moreover, in the case of natural hazard events, related impacts may be less concentrated on individual regions, but affect the entire territory at the same time. The IMF's categorization of Small Developing States (SDS) could serve as proxy for small insurance markets.

⁴ Countries with low income and weak fiscal positions should be given priority to receive PCS to compensate their weaker capacity for paying CDRI premiums. Regarding countries' economic status, IDA eligibility could serve as a proxy for severely restricted ability to pay. With view to their fiscal position, countries' debt stress can be considered to understand their debt status. These considerations may also include industries such as micro, small, and medium enterprises (MSMEs) that contribute to employment, but lack liquidity/working capital as well as people at-risk or below a certain threshold of ability to recover. In this context, a second proxy that can be used to determine *both*, countries' economic *and* debt status is a combination consisting of the World Bank-IMF Bank Debt Sustainability Framework for Low-Income Countries (LIC-DSF) list and market access countries (MAC). MACs typically have significant access to international capital markets, while low-income countries (LICs), meet their external financings needs mostly through concessional resources. Further, to support prioritization amongst countries that meet these requirements in the context of the EDS eligibility criterion, their Highly Indebted Poor Countries (HIPC) status can be considered.

⁵ This should consider countries' current and future exposure and vulnerability to climate risks. There are various indices globally such as the Global Climate Risk Index, the Verisk Climate Change Vulnerability Index, the ND-GAIN country index or the Climate Vulnerability Monitor that can be anchored to determine vulnerability and exposure to climate-related hazards as a key data point. In this context, it should also be noted that countries' PCS level should be climate risk adjusted, translating into higher support needs as climate change progresses over time, not only in the context of PCS but also adaptation investments. Underlying these considerations is the recognition that (future) premium prices will increasingly reflect the accelerating frequency and intensity of sudden onset events, such as droughts, hurricanes, and heavy rain, and thus increase. This will, in turn, add further insurance affordability and access constraints. For example, if climate change impacts livelihoods to a point of unsustainability, this is likely to be reflected in the insurance policy – either through increased premiums or more limited coverage.

with high income, but are climate vulnerable and have purchased no or little insurance. While most likely reflecting low sensitivity to PCS, that is a low impact of PCS on these actors' **ability** to pay, there is supporting evidence **that PCS can positively influence these actors' 'willingness to pay' (WTP) and hence increase the uptake of insurance.** In such contexts, market-accelerating PCS interventions may be best suited and applied only in the short to medium term, but with potentially high impact.

6. **Category 2 - PCS for climate vulnerable lower-income countries, industries, and people (with lack of ability to pay):** Many countries in this category include low-income countries with moderate to high debt stress based on LIC-DSA framework. In contrast to the above introduced category, purchasing disaster risk insurance presents particularly high opportunity costs - countries in this category would show high sensitivity to PCS, meaning their ability to pay could be increased substantially. At the same time, PCS interventions would have to be much longer term than the above to even reach the potential of creating sustainable insurance markets and should consist of a mix of market-accelerating and social protection-based PCS measures. Looking at countries listed in the context of extremely restricted fiscal space and at risk of external public debt distress, further identification and prioritization for PCS should consider these countries' climate vulnerability. In the context of national industries, these considerations may also include MSMEs that contribute to employment, but lack liquidity/working capital as well as people at-risk or below a certain threshold of ability to recover.
7. **Category 3 - PCS for Small Market Low Income Countries (SDS, lacking ability to pay).** Small markets which include Small Developing States (SDS) are among the most vulnerable to climate impacts. At the same time, SDS also have small and limited diversified economies and small populations (~under 1.5 million), and thus highly limited fiscal space while often also suffering from high external public debt disaster. Similar to category 2, PCS measures would need to be longer term and consist of a mix of market-accelerating and social protection-based interventions, depending on the scale of the mechanisms PCS is being provided for. The IMF's classification of SDS can serve as an indicator for small countries with needs PCS for CRDI, again with priority given to regions/countries with high climate-related exposure and vulnerability.
8. With view to determining the time span for which PCS should be provided, the below presented variables offer an initial account of the elements to be considered to determine the need for short, medium- and long-term PCS interventions.



9. Lastly, with view to determining the **size of PCS** that would need to be allocated in support of a specific insurance scheme, considerations related to **(1) Need, (2) Optimality and (3) Sustainability** should be taken into account.
10. In the context of **needs-based considerations**, the **relative impact on fiscal cost arising from the cost of premiums should affect the size of PCS allocations**. Countries with higher impact, should therefore receive higher PCS levels. The same applies for countries where **a share of capital output larger than their expected average losses is at risk from low frequency/high severity events** and countries with a **relatively higher insurance premium-to-GDP ratio**.
11. **Optimality** speaks to the optimal level of insurance in the context of providing better protection for growth and recovery. **Optimal insurance levels should be defined in the context of the previously discussed aspects around economic growth and debt**, with the **size of PCS being defined in proportionality to the optimal level of insurance**.
12. Lastly, with view to **sustainability**, **PCS levels should be set with reference to a lower bound threshold beyond which PCS might lead to unsustainable outcomes**. More specifically, while PCS should, at minimum, make the targeted insurance mechanism or project viable (lower bound), it should not substantiate moral hazard or dis-incentivize other risk reduction measures.

V. Key Requests towards an international support structure for Premium and Capital Support

1. To pursue the above stated objectives, the V20 need to push forward the international dialogue on the provision of PCS, specifically in the context of the

InsuResilience Global Partnership and with its' respective G7 and G20+ members. This dialogue will also need to be situated within and aligned with other related international discussions and implementation initiatives, e.g., the call on the G7 to reform international crisis finance and the V20-led Sustainable Insurance Facility (SIF).

2. As outlined in this note, priority topics include the formalization and adoption of commonly agreed-upon principles and further discussion on their reliable and sustainable operationalization. The latter also requires a commitment by the international donor community and V20 country governments to share experience and evidence in the context of monitoring and evaluation. Furthermore, the V20 and the members of the InsuResilience Global Partnership may collaborate on making the international delivery structure for PCS more systematic. For these purposes, the V20 may support a call for a task force consisting of key members of the InsuResilience Global Partnership.
3. As mentioned in (2), additionally to the request for a rules-based provision of PCS in line with the five SMART Principles outlined in section II and the accounting of individual V20 country characteristics when deciding upon the allocation, amount and period for which PCS is provided, as stated in section IV, the fragmentation and in-transparency of the international delivery structure of PCS needs to be reduced.
4. Currently, the provision of PCS through different institutions, including donors and different funds administered by the World Bank or the African Development Bank on behalf of donors, such as the Global Risk Finance Facility (GRiF) or the Africa Disaster Risk Financing Programme (ADRFi), seems insufficient and rather ad-hoc and arbitrary. As a consequence of this fragmented provision of PCS, countries lack clarity with view to engagement with delivery partners and delivery structures. Furthermore, the current delivery structure of PCS may lead to sub-optimal outcomes, given information and relationship asymmetries between institutions such as regional MDBs and the World Bank with view to specific programmes and governments.
5. In reducing this fragmentation to increase efficiency gains and uptake of CDRI through PCS, the **three elements when discussing the design of an internationally accessible and systematic delivery structure for smart PCS** for micro, meso and macro schemes, need to **include: 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.**
6. With view to macro level instruments, sovereign risk pools like CCRIF-SPC and ARC as well as global financing facilities specifically aimed at (sub-) sovereign risk, such as the World Bank's Global Risk Financing Facility (GRIF), may represent feasible delivery channels. However, for micro and meso level insurance schemes, the situation seems more fragmented.

7. Potential options to explore may include an international investment fund structure modelled, for instance, on the example of the InsuResilience Investment Fund (IIF), which has been set up by the KfW Development Bank and is managed by the global impact investment manager BlueOrchards. Operating through sub-funds, the IIF provided capital support in the form of debt and equity investments to existing or new (re)insurers based or operating in climate vulnerable countries. Another option could be to set up funds within regional multilateral development banks (MDBs), such as the Asian Development Bank (ADB), the African Development (AfDB) or the Inter-American Development Bank (IADB), requiring the submission of PCS requests by implementing entities or governments. As per the GRiF's concept note, regional MDBs may be eligible to access the GRiF, implying that such an established fund structure may therefore also help to further streamline the global support and implementation of CDRI. Moreover, given the strengthening of macro-to-micro approaches, where regional risk pools become increasingly involved in the design and implementation of micro and meso insurance schemes, regional pools may provide an additional route via which smart PCS for these levels may be made more systematic.

8. Underlying the process of building such an aligned architecture, which is more responsive to individual country and regional contexts should be the **intent to establish financing facilities that can deliver PCS to diverse set of actors, including national institutions and the private sector, while maximizing opportunity of competition between said facilities.**