

Challenges and opportunities in applying financial instruments to loss and damage

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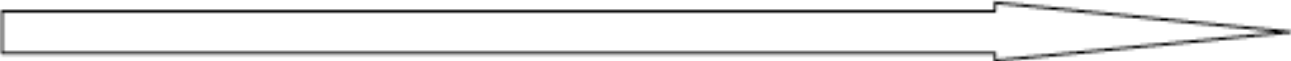
*4th Forum of the Standing Committee on Finance
“Financial instruments that address the risks of
loss and damage”*

Manila, September 4&5 2016

Guiding questions

- How are financial measures linked to Loss and Damage?
- Which types of instruments have been used for different levels, e.g. local/community, national and regional?
- What can be said about best practice?
- What are gaps and how might existing financial instruments be combined to complement each other?

What are the risks we are talking about and what set of measures can be used?



Avoided	Unavoided	Unavoidable
Avoidable damage avoided	Avoidable damage and loss not avoided	Unavoidable damage and loss
→ Damage prevented through mitigation and/or adaptation measures.	→ Where the avoidance of further damage was possible through adequate mitigation and/or adaptation, but where adaptation measures were not implemented due to financial or technical constraints.	→ Damage that could not be avoided through mitigation and/or adaptation measures; e.g., coral bleaching, sea level rise, damage due to extreme events where no adaptation efforts would have helped prevent the physical damage.

Source: Verheyen, 2008

Prospective measures

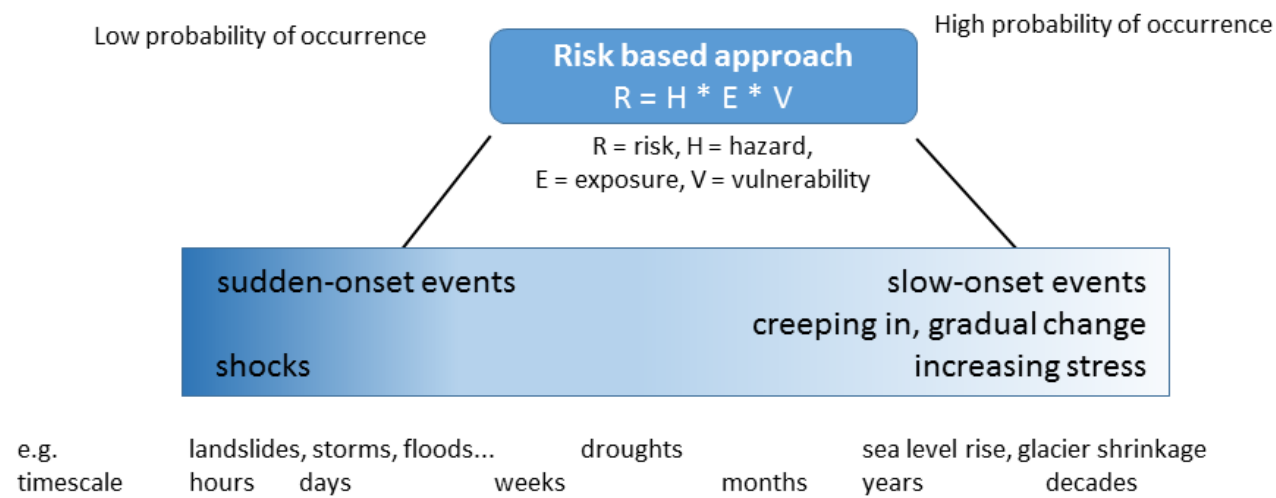
Avoiding risks *ex-ante* through comprehensive disaster risk management incl. risk financing (insurance etc.)

Curative measures

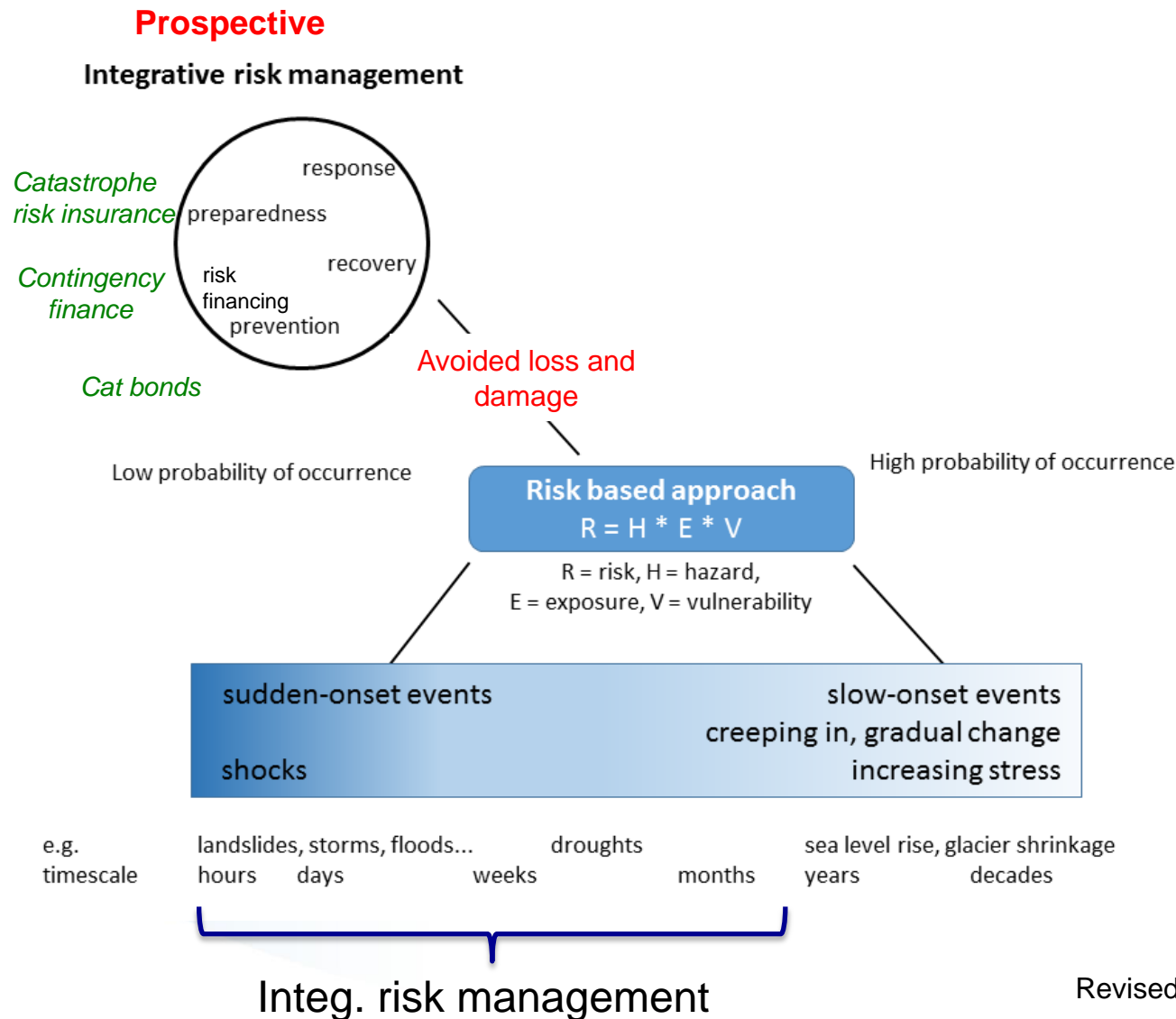
Dealing with unavoidable and unavoidable impacts *ex-post*

Mechler and Schinko, 2016

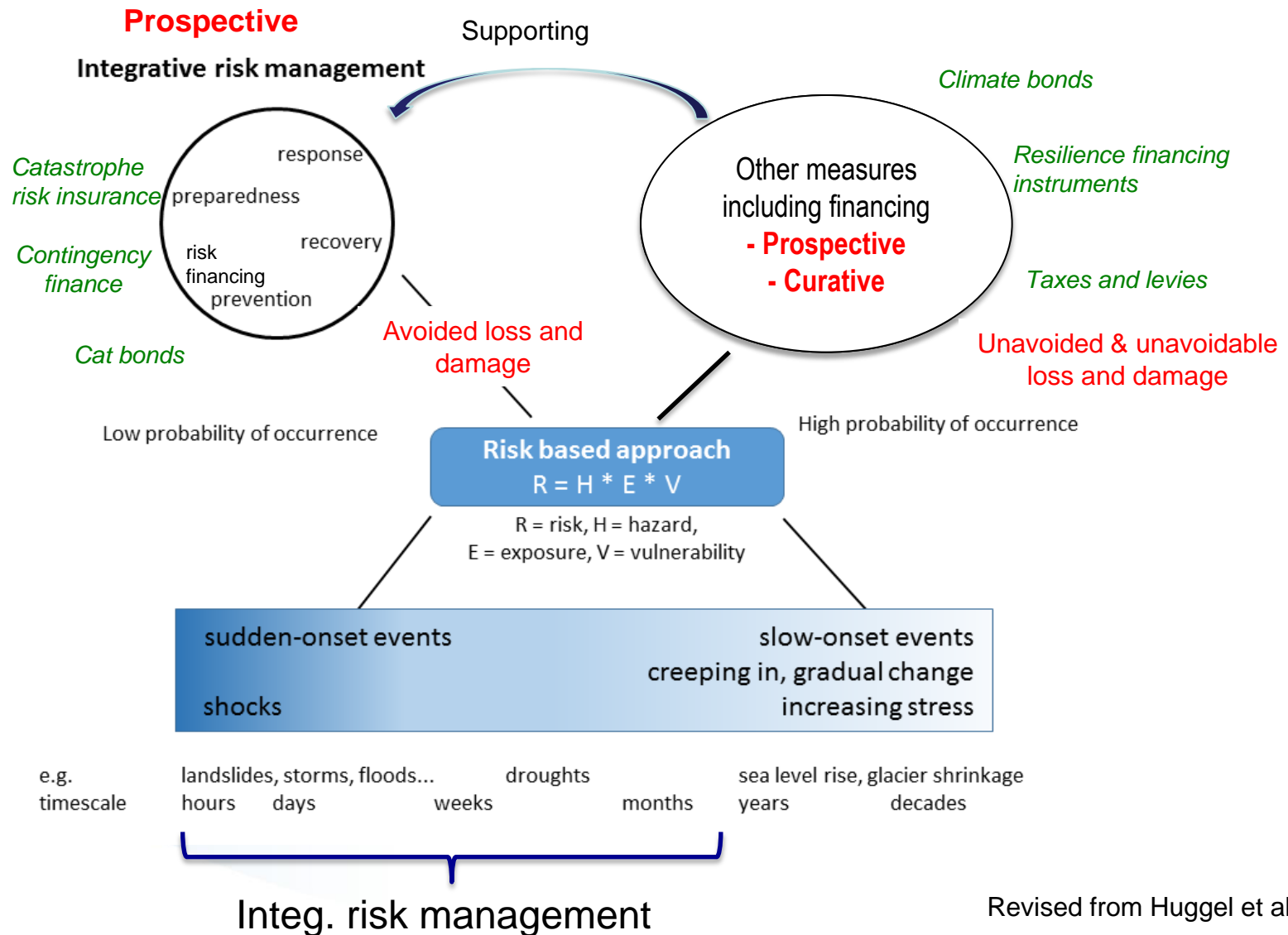
Types of climate-related risks to be covered



Measures and risks - building on ExCom 2016 technical paper on financial instruments



Measures and risks - building on ExCom 2016 technical paper on financial instruments



Revised from Huggel et al., 2016

Prospective measures for risk management

Spectrum of formal and informal instruments for financing loss & damage

- Pooling and sharing risks to diversify risks integrated with a broader view towards comprehensive DRM and building resilience
- Innovative instruments involving Public Private Partnerships
- *Risk financing mechanisms at local, national, regional, and global scales contribute to increasing resilience to climate extremes and climate variability, but involve major design challenges so as to avoid providing disincentives, causing market failure and worsening equity situations (IPCC AR5, WG II, Ch.17: Chambwera et al., 2014)*

Prospective measures for risk management

Spectrum of formal and informal instruments for financing loss & damage

	<i>Local Households, Farmers, SMEs</i>	<i>National Governments</i>	<i>International Development organizations, donors, NGOs</i>
<i>Solidarity</i>	Help from neighbors and local organizations	Government post-disaster assistance; government guarantees/bailouts	Bilateral and multilateral assistance, regional solidarity funds
<i>Informal risk transfer (sharing)</i>	Kinship and other reciprocity obligations, semi-formal micro-finance, rotating savings and credit arrangements, remittances		
<i>Savings, credit, and storage (inter-temporal risk spreading)</i>	Savings; micro-savings; fungible assets; food storage; money lenders; micro-credit	Reserve funds; domestic bonds	Contingent credit; emergency liquidity funds
<i>Insurance instruments</i>	Property insurance; crop and livestock insurance; micro-insurance	National insurance programs; sovereign risk transfer	Re-insurance; regional catastrophe insurance pools
<i>Alternative risk transfer</i>	Weather derivatives	Catastrophe bonds	Catastrophe bonds; risk swaps, options, and loss warranties

Yellow: risks addressed explicitly – risk financing instruments

White: risks addressed implicitly/ad hoc

IPCC, 2012 (Murray et al., 2012)

Prospective measures for risk management

Spectrum of formal and informal instruments for financing loss & damage

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Assessment Criteria

Specific

- Comprehensive perspective on risk

General

- Acceptability
- Pro-poor impact
- Effectiveness
- Efficiency
- Equity
- Governance

→ MCII/UNU-EHS with comprehensive assessment for InsuResilience Initiative

Example Local/Micro level

R4 Rural Resilience Initiative (drought)

- Ethiopia, Senegal, Malawi, Zambia
- Smallholder farmers' livelihoods in drought-prone northern state of Tigray in Ethiopia exposed to weather shocks
- **Integrated risk management framework**
 - **Improved resource management (risk reduction)**
 - **Individual/group savings (risk reserves)**
 - **Microinsurance (risk transfer)**
 - **Microcredit (risk taking)**
- “Insurance-for-work” program on top of the government’s “food and cash-for-work” Productive Safety Net Programme (PSNP)
- Work program includes projects for reducing risk and building climate resilience, such as improved irrigation or soil management.
- Index-based insurance pays for a seasonal drought and payouts are triggered automatically when rainfall drops below predetermined threshold
- Partners: farmers, local relief society, insurers, reinsurers, rural bank., university, government and donors



Example National/International-Macro level

African Risk Capacity ARC (drought)

- Sovereign drought insurance pool and response mechanism linking
 - Risk reduction: pre-approved drought contingency plans
 - Risk financing: index-based payout to governments for implementing plans
 - Risk signal: Trigger additional funding if climate variability changing
- 7 African countries with aim to reach 30 by 2020

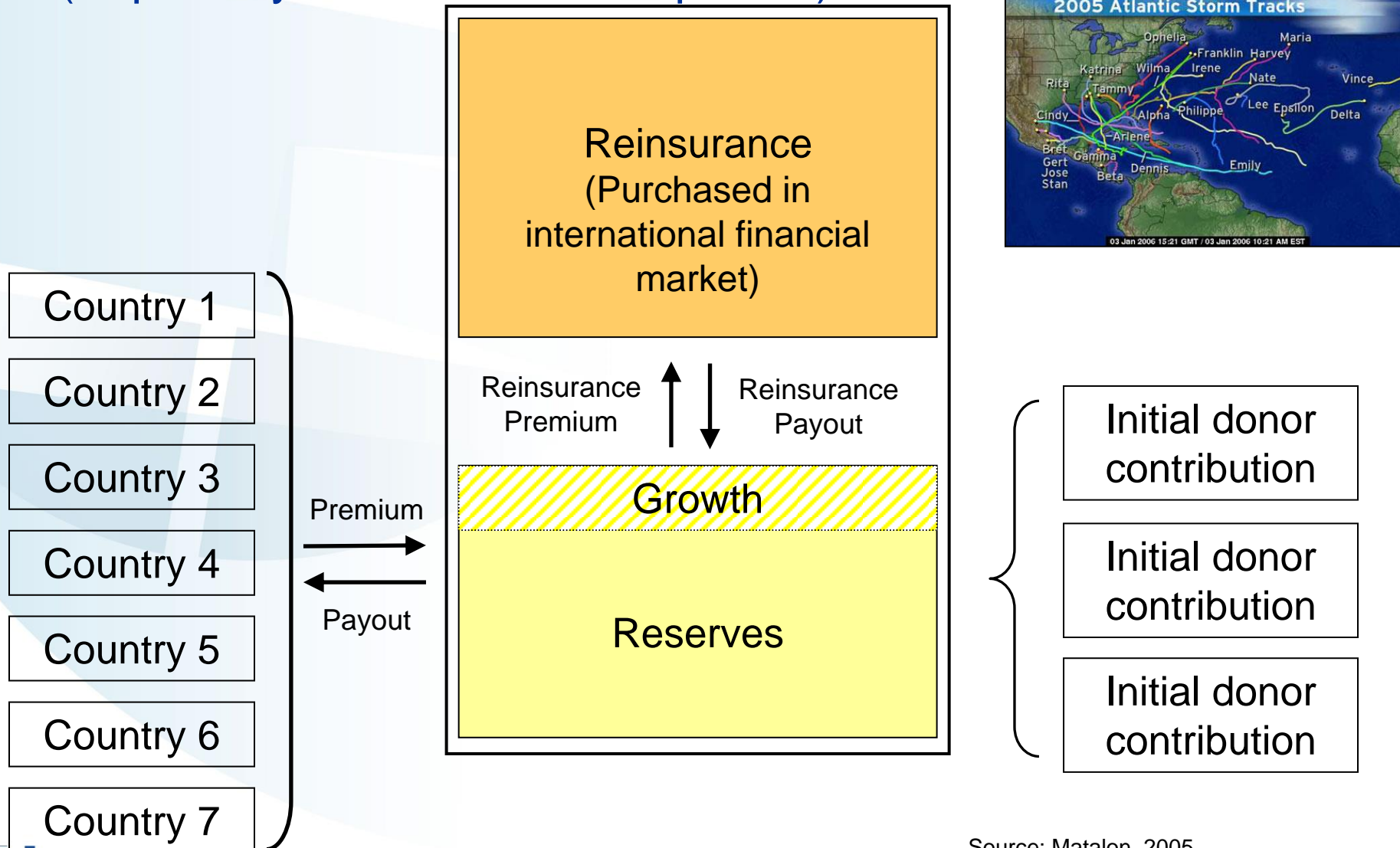


ARC, 2016

Example National/International-Macro level

Caribbean Catastrophe Risk Insurance Facility (CCRIF)

(tropical cyclones and earthquakes)

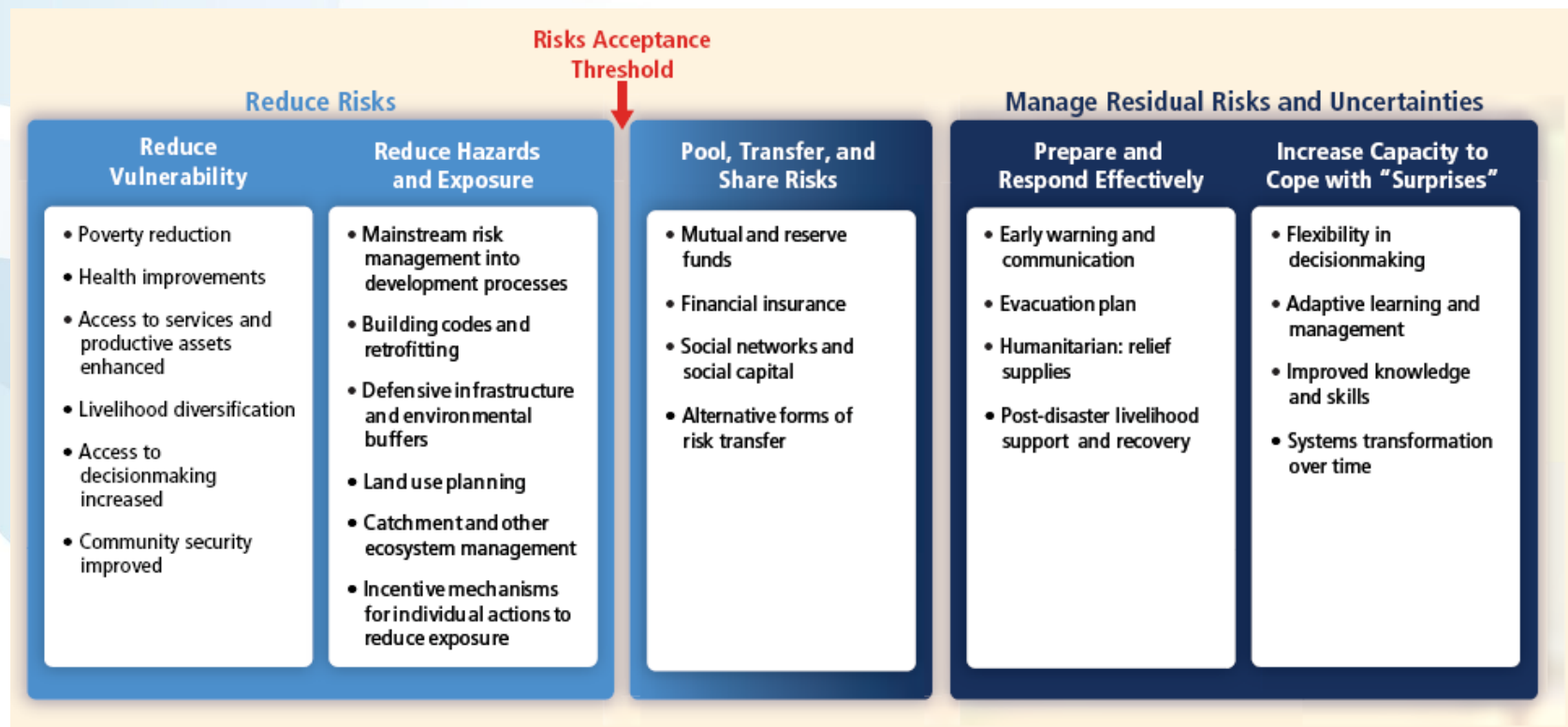


Source: Matalon, 2005

Risk financing as part of comprehensive climate risk management

IPCC, 2012

Effective climate risk management portfolios integrate sound risk analysis, risk reduction, risk financing, response and opportunities for learning



Other measures discussed in technical paper

- Climate bonds, resilience financing, taxes and levies etc.
 - May have a **prospective** function: financial support for instruments/climate risk financing for premium subsidy, reserve capital, technical assistance
 - May have a **curative** function: dealing with unavoided and unavoidable loss and damage
- Cover all types of risks, and loss and damage
- Not well tested for this context
- Debate and innovation necessary part. with regard to the curative function

Summary

- Instruments for the **prospective space** seeing attention across scales and can build on innovation in the DRM/adaptation domains
 - Avoiding loss and damage
 - Cover sudden-onset and some slower-onset events
 - Integrative risk perspective as best practice: risk reduction - > risk financing-> risk taking
 - Assessments exist
- Instruments for the **curative** space less clear as novel territory
 - Unavoided and unavoidable loss and damage

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