Political Champions

Partnership for stimulating insurance penetration in lower income countries

Initial Market Surveys: Summary Note

Executive Summary

After the last Champions' meeting in April, an expert-level group consisting of donors, insurers and international financial institutions was formed to act on the decision to undertake joint work to scale up disaster risk insurance[1] in lower income countries. Seven countries were selected: Bangladesh, Ghana, Haiti, Kenya, Senegal, Tanzania and Vietnam. The World Bank/Global Facility for Disaster Reduction and Recovery (GDFRR) led in preparing country scoping studieswith inputs from the group. These were summarized in a set of country notes.

From the country scoping studies, the expert-level group proposes that **Kenya**, **Bangladesh** and **Senegal** are selected for the next phase. This will involve confirming the interest and commitment of the governments to engage in this initiative and undertaking field visits to conduct more detailed, in-country assessment to identify opportunities for scaling up insurance in support of building resilience.

Each assessment will result in a recommended programme of investment to stimulate insurance scale up. This will include recommendations on how to improve the coordination of existing efforts, how to fill gaps (such as continued investment in market infrastructure), how to scale up pilot initiatives and how to better link insurance solutions to existing financial products (such as credit) and social protection programmes. By early 2014, the assessments will be completed. By April 2014, the recommended programme of investment for each country will be presented to the donor and insurance community involved in this Political Champions' initiative for their consideration and commitment of support.

Decision Point: The Champions are being asked to review and endorse the proposals: 1). to undertake in-depth assessments in **Kenya**, **Bangladesh** and **Senegal**; and 2). to hold a meeting of key donors and insurers by April 2014 to consider recommended programmes of investment.

Background

Over the past 20 years, natural disaster losses have been steadily climbing in both advanced and developing countries. Disaster-related economic losses exceeded US$400 billion in 2011, the highest ever recorded in history. The Great East Japan Earthquake alone resulted in more than US$210 billion in damages. Insured losses of over US$55 billion (out of US$140 billion total natural disaster losses) made 2012 another record year for the insurance industry. The upward trend in natural disaster losses is exacerbated by growing urbanization, environmental degradation, and expected increases in the frequency and severity of hydro-meteorological events resulting from climate change. Developing countries are particularly vulnerable as they cannot keep pace with the rapidly growing asset bases at

[1]Disaster risk insurance refers to agricultural (crop and livestock) and other property related insurance at the retail (i.e. enterprise and household) level, where losses are caused by natural events. The particular interest is to expand access to risk management instruments in resilience deficit areas.

risk and do not have adequate resources to dedicate to reducing exposure or responding effectively to an emergency.

Insurance offers opportunities to transfer catastrophe risks to private investors but remains largely under-utilized in developing countries. Disaster risk insurance markets[2] remain largely under-developedin developing countries, so forcing governments and the households to retain most of the losses post disaster. The main reasons of low catastrophe insurance penetration are multiple: limited risk data infrastructure, lack of insurance production systems (e.g., underwriting, product design and pricing, claims settlement), limited delivery channels, weak or missing regulatory frameworks, low consumer awareness, etc.

Many governments increasingly recognize the need for comprehensive disaster risk management strategies, including well-developed catastrophe risk insurance markets, to achieve sustainable development. In 2012, Finance Ministers from the G20 and APEC highlighted the importance of financial resilience against disasters, and the Sendai Dialogue at the IMF-World Bank Group Annual Meetings demonstrated commitment to the topic at the highest levels. The 2014 World Development Report states that risk management, including disaster risk financing and insurance, can be a powerful instrument for development. The European Commission produced in 2013 a Green Paper on the insurance of natural and man-made disasters, posing a series of questions concerning the adequacy and availability of appropriate disaster insurance and how to improve the market for disaster insurance.

The Political Champions Group for Disaster Resilience in April 2013 introduced a new initiative for a stronger partnership between the public sector and the private sector to increase disaster resilience of vulnerable populations using market-mediated insurance solutions. *An expert-level group, including*representatives of DFID, USAID, WB, ILO, GIZ, SECO, European Commission, Swiss Re, Munich Re, Willis and Allianz*was established to support this work.* Their first task wasto identify a list of countries to conduct initial market assessment,based on pre-defined criteria[3]. See Table 1 below. *Seven countries were selected: Bangladesh, Ghana, Haiti, Kenya, Senegal, Tanzania, and Vietnam*. .

[2] In this note, disaster risk insurance encompasses property catastrophe risk (micro-)insurance (e.g., for private dwellings) and agricultural (crop and livestock) insurance where losses are caused by widespread adverse natural events.

[3]The following eligibility criteria were: Exposure to natural disasters;Existence of some risk market infrastructure (including data infrastructure), or at least clear possibility to develop it; Strong interest/commitment of the government, as most programs build on PPP; Strong interest from the domestic insurance industry, financial institutions and international reinsurance industry, with a clear champion(s); Linkages with the DRM or agricultural risk management agenda; Leverage with existing initiatives/projects, where there is proof of concept; Growing interest or demand for insurance, which in time would allow meaningful market volumes; At least half of the selected countries are low income countries; benefits of insurance will assist, directly or indirectly, some of the more vulnerable people or regions of a country.

Table 1. Initial Market Assessment - List of Selected Countries

	WB country classification[1]	WorldRiskIndex[2]	Non-life insurance penetration (% GDP)[3]
Bangladesh	LIC	17.45 %	0.25%
Ghana	LMIC	9.35%	0.58%
Haiti	LIC	11.45 %	0.34%
Kenya	LIC	7.82%	2.02%
Senegal	LMIC	11.76 %	0.81%
Tanzania	LIC	8.64%	0.63%
Vietnam	LMIC	11.21 %	0.78%

(1) World Bank country classification. LIC: Low Income Countries; LMIC: lower Middle Income Countries.
(2) World Risk Report 2011. The WorldRiskIndex indicates the probability that a country will be affected by a disaster by combining exposure to natural hazards, susceptibility (as a function of public infrastructure, housing conditions, nutrition and the general economic framework), coping capacities (as a function of governance, disaster preparedness and early warning, medical services, social and economic security), and adaptive capacities to future natural events and climate change. The 2011 Index ranges from 32% for Vanuatu, the riskiest, to 0.02% for Qatar.
(3) AXCO Global Statistics (2012) and Swiss Re Sigma Report (2013).

Seven country notes based on initial market surveys were produced (Phase 1).Thecountry notes provide an initial, non-exhaustive review of disaster risk financing and insurance activities in the seven selected developing countries, based on the inputs provided by the working group. The notes review (i) government's public financial management of natural disasters, (ii) ex-ante and ex-post public interventions from government and donors against natural disasters, (iii) and state of the domestic non-life insurance market. In conclusion, the notes identify potential opportunities for investments to promote domestic catastrophe/agricultural risk insurance solutions.

In the next phase (Phase 2), it is proposed to conduct a detailed market assessment for three countries.Based on the findings of the initial market surveys, a short list of three countries has been identified where more detailed assessment (including country visits) will be conducted. This will also include initial discussions with the governments to secure their support in this initiative.

Phase 2 would lead to recommendations for an investment plan,which will be presented to a meeting of donors and insurers in early 2014.

Findings from the market surveys

This initiative aims to increase disaster resilience of vulnerable populations through market-mediateddisaster risk insurance solutions, built on a strong partnership between the public and private sectors.Insurance solutions that do not scale up cannot have a substantial impact on vulnerability. Experience suggests that sustainable, scaled up disaster risk insurance programs are based on an equal partnership between the public and private sectors. The limited success of many private

sector agricultural insurance pilots can partly be explained by under-developed risk market infrastructure; lack of coordinated investments in key public goods such as data, lack of technical capacity of local stakeholders including domestic insurers, and absence of public institutions with sufficient capacity to ensure competitive markets and consumer protection.

Experience suggests that making disaster risk insurance compulsory (e.g. linked to credit) and/or integrating it within social protection programs can produce the critical market size required to support continued investments in the risk market infrastructure.Many large scale agricultural insurance programs in low and middle income countries (e.g. India, China) have achieved scale in part due to insurance being bundled with agricultural credit on a compulsory basis. Turkey's earthquake insurance program (TCIP), which currently protects over 4 million households, achieved scale in part due to coverage being compulsory for homeowners. As an example of a social safety net program which uses agricultural insurance principles, Mexico's CADENA provides agricultural insurance to over 2.5 million targeted smallholder farmers, with the US$100m total annual premium paid in full by federal and state governments. Provision of a catastrophe level of risk insurance to vulnerable households not only reduces the government's potential liabilities, but crowds in the provision of more commercial layers of insurance, which reduces overall risk exposure as well.

The Political Champions Group could support the funding of a package of investmentsto shift from ex post to ex ante disaster risk financing using market-mediated insurance solutions and the high level political commitment required for such a public private partnership approach in priority countries.In many countries, public responses to disaster risk are driven by ex-post rather than ex-ante approaches. For example, in the aftermath of a large shock to agricultural production, public funds might be used to support vulnerable farmers or to bail out troubled lenders. Ex-post approaches can be slow as it can take time to reallocate public funds from other activities. They also typically offer unreliable protection to the intended beneficiaries and can adversely distort agricultural risk management decisions. A move to an ex ante market-mediated insurance regime (where in the advance of a potential disaster, investments are made in mechanisms to support the resilience of farmers, herders and supply chains) is one way that can help lead to more timely, efficient, equitable, reliable and transparent protection being available to intended beneficiaries.

- ***Kenya***has well-established insurance and banking sectors, both of which have demonstrated high levels of capacity. Kenya represents an excellent opportunity to make targeted investments aimed at increasing disaster resilience among vulnerable population using market-mediated solutions. For example, a multi-donor, private sector supported pilot on livestock insurance for pastoralists in Northern Kenya has established proof of concept. Links could also be explored to integrate this, or other insurance products, into social safety net programs, such as the Hunger Safety Net Program, which is implemented in the resilient-deficit arid and semi-arid lands. Coordination with broader Horn of Africa resilience efforts, such as those of the Global Alliance could also be explored.

- ***Bangladesh***offers opportunities to increase the outreach of insurance to larger sections of the population, especially to those most vulnerable to the substantial exposure to numerous hazards. The micro-finance market is well developed and provides opportunities to expand the still very limited availability of micro-insurance propositions to the rural population. Index-based insurance programs supported by mobile payment systems have already been piloted and there is considerable scope for this to be expanded, especially when appropriately subsidised to address affordability issues. However, this will require further strengthening of the insurance

market, in respect of the implementation of the Insurance Act 2010 and of consumer representation, which is underdeveloped but may contribute strongly to improve the public's confidence and help the industry to develop successful propositions also for emerging customers.

- There may be opportunities for targeted investments in ***Ghana,***especially the northern part more prone to drought, aimed at increasing disaster resilience among vulnerable populations.Links could be explored developing governmental plans to expand social welfare programsusing market-mediated solutions; for example, the government plans to expand the coverage of the Livelihood Empowerment Against Poverty Program (LEAP) by over ten-fold in the next three years. These mechanisms could scale up programs against post flood events or drought events in the north. Donors could provide technical assistance to the government to enable them to integrate insurance instruments into their social welfare programs, which are being expanded. Using local insurance capacity to bear some of the risk and develop the insurance products could be investigated. Such mechanisms delivered through social welfare programs would create a critical mass of policyholders, which could spur the development of a more commercial layer of agriculture insurance. Those investments should leverage the considerable work already carried out by key donor partners such as GIZ in association with Government agencies.

- There is a unique window of opportunity for micro-insurance in***Senegal*** as specific regulation is being implemented. This has generated momentum that can significantly grow the outreach of insurance but calls for technical and financial support. The most immediate opportunities for promising multi stakeholder interventions in Senegal are in agriculture insurance – especially in the more resilient deficit areas of Eastern Senegal. Credit linked property microinsurance against floods could also be explored.

- Expansion of disaster risk insurance into ***Tanzania***could be seen as a second phase of an engagement looking to develop these markets in Eastern Africa, with Kenya targeted in the first phase. Banking penetration in Tanzania is low, as is insurance and microinsurance penetration, even when compared to regional countries. In addition, the insurance industry has struggled in recent years with profitability, indicating that insurance technical capacity within the country may be limited. Given the comparative advantages of engaging in Kenya, a potential course of action would be to use Kenya as a demonstration case in east Africa to spark interest in the Government for development of catastrophe and agriculture insurance markets.

- ***Haiti*** has world champions of catastrophe insurance at the macro and micro level; the Caribbean Catastrophe Insurance Facility (CCRIF), the Micro-insurance Catastrophe Risk Organisation (MiCRO), and the Alternative Insurance Company (AIC),Nonetheless, there are various opportunities to help scale up the impact they currently have. Social protection has become a priority of the government, and can be further strengthened with market-mediated insurance mechanisms, like for example cash transfers that increase in amount or outreach based on specific populations' needs approximated by disaster loss indices. Haiti can benefit from a growing body of evidence that shows how public private partnerships and the use of insurance related principles benefit low income households.

- **Vietnam** has embraced insurance mechanisms in disaster risk management and agriculture more vigorously than most developing countries. But some initiatives like the disaster risk

reduction (DRR) strategy's mandate to implement disaster risk insurance are yet to be conceived, while others such as the agriculture insurance scheme have been launched but experienced unsustainable outcomes and need strengthening. Technical assistance to guide this process can have substantial impact, and could include the consolidation of available risk modeling and hazard maps and closing major gaps these may have. Appropriate insurance of public assets would further strengthen the property insurance sector and justify investment in risk models and underwriting expertise that will subsequently be available for businesses and households.

Recommendations

1) **Country Selection for Phase 2.** Based on the preliminary findings of the country notes and follow up technical discussions of the expert-level group, it is proposed that the next phase will further narrow the focus on the countries that offer the greatest potential for success, yet remain consistent with the PCG resilience agenda. To that end, it is recommended that this next phase focus on the following countries: **Kenya, Bangladesh and Senegal**.

2) **Agenda and work plan for this initiative.** The technical working group has proposed the following activities and timeline :

By early 2014—In-depth field assessments: The Political Champions Group will invite the governments of selected countries to actively participate in a fiscal, market and impact assessment to determine specific action and investments in order to scale up insurance**.** This assessment will investigate the fiscal costs, political and commercial feasibility and potential social impact of scaling up public private partnership in, for example, agricultural insurance linked with social protection and/or credit. This could include a national stakeholder workshop, a report on the results of the assessment, and a suggested roadmap for implementation. Where possible the process would leverage existing complementary initiatives and efforts.[4]

By April 2014—Investment plans: Analysis from the assessment and stakeholder consultation will inform the development of a programme of investment for each country. These will be presented to donors and private sector partners will take placeby April 2014. The objective of the meeting will be to seek commitment of political and financial support.

2014 and beyond—Scaling-up implementation: Implementation of mutually agreed market-mediated disaster risk insurance solutions in these three countries.The solutions will generated in the light of the findings of the detailed assessments conducted in Phase 2 and the outcome of the meetings with donors and private sector partners. They could potentially build on the following three areas of support, to be tailored to each country.These possible activities would aim to create an enabling policy and technical environment to promote sustainable and affordable market-mediated disaster risk insurance solutions aims to increase disaster resilience to vulnerable population.

a. ***Investments in data risk infrastructure***. Coordinated investments in collecting, auditing and managing insurance-quality yield, remote sensing, and weather data allows insurance providers to design indexed products that offer affordable, reliable protection against large agricultural shocks. New datasets would need to be collected and existing data collection processes would

[4] For example, this assessment could build on the ongoing agricultural risk assessments conducted under the G-8/New Alliance, complementing such an assessment with detailed analysis of agricultural risk financing and insurance options and the role of the private insurance sector.

need to be enhanced or protection is likely to be poorly targeted (high basis risk), slow, and either expensive or totally unavailable. If such investments are made, data and indices should be used across the continuum from purely social programs which can benefit from risk-based prices and responsive, timely, disciplined post-disaster payouts to purely commercial programs, which can benefit from improved indices and larger premium volume. For this to be achieved, data for insurance indices should be regulated as a public good, available to all market players on standard terms.

b. ***Technical Assistance to domestic insurance market through a technical support unit***: Actuarial and other specialist expertise can be expensive. An international model used successfully to manage this cost would to house such expertise centrally, for example within a Technical Support Unit.

c. ***Investments to support affordable risk financing whilst initial investments in data are being made.*** With the exception of countries which already have a large scale agricultural insurance program in place, most developing countries do not currently have the data collection and audit processes necessary for such a program. They may collect some yield, weather or satellite data but are unlikely to collect and audit it to the standards of international reinsurers. However, in the early years of a new program, whilst new or enhanced data collection or audit processes are being piloted, reinsurance can be expensive. Moreover, even when a long time series of data is available, reinsurance can be expensive for catastrophic events which remain difficult to quantify. Such high reinsurance uncertainty loads for risk which cannot be well quantified are necessary due to modern approaches to prudential regulation and credit rating for reinsurers. This means that high layers of risk (covering low probability events) and elements of coverage based on new datasets (designed to reduce basis risk) are typically expensive to reinsure. A risk financing fund which provided risk financing on best estimate cost basis to programs investing in improved data sources would be a cost-effective way to support development of viable products.