INSURANCE EFFECTIVENESS: OBJECTIVES AND EXPECTATIONS

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OUTLINE

- APN project background
- Workshop objectives
  - Issue I: DRR and CCA benefits
  - Issue II: Evidence for effectiveness
  - Issue III: Alternatives for insurance
- Questions for the workshop
Title: Assessing community risk insurance initiatives and identifying enabling policy and institutional factors for maximizing climate change adaptation and disaster risk reduction benefits of risk insurance

Donor: Asia Pacific Network for Global Change Research (APN) under ARCP funding stream.

Collaborators: IGES, EeMausam India Ltd., IAfD, UKM-SEADPRI and UPLB

Duration: 2.5 years starting from Jan 2014.
OBJECTIVES

1: To identify technical, socio-economic, institutional and policy barriers limiting penetration of risk insurance

2: To assess climate change adaptation and disaster risk reduction benefits and costs accrued through risk insurance initiatives [Workshop]

3: To identify enabling environment to scale up risk insurance: What policy and institutional processes can help scaling up risk insurance

4: To sensitize policy makers and other stakeholders about scaling up the risk insurance
WHAT IS THIS WORKSHOP ABOUT?

- **Issue I:** What are disaster risk reduction (DRR) and climate change adaptation (CCA) benefits (and costs) and how to assess insurance approaches for these benefits? [Should it really be the question, are we asking for more?]

- **Issue II:** Despite ‘known’ benefits of insurance, what evidence do we have on how insurance is benefiting communities leading to a longer term DRR and CCA outcomes?

- **Issue III:** Should insurance be a go-to-tool for the most vulnerable and poor? Should we be looking for alternatives in a more proactive manner?

  Are we asking priest if he believes in atheism!
ISSUE I: INSURANCE EFFECTIVENESS VIS-A-VIS CCA AND DRR

Traditional understanding of effectiveness:
- Has the insurance delivering the contractual obligations i.e. payoffs as agreed in the contract.
Is this sufficient?

- Most literature and experiences talks insurance effectiveness in terms of
  - How many people are insured (Economies of scale),
  - How to avoid moral hazard and adverse selection,
  - Minimizing basis risk
- This gives an impression that the insurance will be successful if the above factors are taken care of!

- How the payoffs are spent?
- Has there been long term reduction in risks?
IN OTHER WORDS...

Vulnerable situation

Resilient situation

Adaptable situation

Drought

Insurance payoff
**TRUE?**

- Will mere paying back of loss amount lead to CCA and DRR benefits?
  - Promoting high risk and profit seeking behavior (with implications for basis risk)
  - How the insurance pay offs are spent by farmers: in risk mitigation or business as usual crop management practices, resulting in no net risk reduction.
  - Subsidized premiums in most developing country contexts: Doesn’t really convey the price signal to farmers leading to no change in crop production practices and no net reduction in cost of risk.
  - Most of these issues are often linked to not just how the insurance is designed but also what kind of support services (e.g. education on risk management) goes to the insurance buyers so that they make informed choices.
ISSUE II: EVIDENCE FOR ADVANTAGES OF INSURANCE

- Emphasis on risk mitigation compared to response
- Provides a cost-effective way of coping financial impacts
- Covers the residual risks uncovered by the other risk mitigation mechanisms.
- Stabilizes rural incomes: reduce the adverse effects on income fluctuation and socio-economic development.
- Provides opportunities for public-private partnerships.
- Reduced burden on government resources for post-disaster relief and reconstruction.
- Helps communities and individuals to quickly renew and restore the livelihood activity.
- Depending on the way the insurance is designed, the insurance mechanism can address a wide variety of risks emanating from climatic and non-climatic sources.

Arnold, 2008; Siamwalla and Valdes, 1986; Swiss Re, 2010
What about Evidence?

- Our literature review has suggested that there is no sufficient evidence on how insurance is proving effective on the ground. What kind of social and economic benefits insurance is offering leading to disaster risk reduction and climate change adaptation outcomes?
Issue III: Is the insurance a go-to-tool for the most vulnerable?

Non-life Insurance Premiums

- North America: 703 USD Billion
- Western Europe: 590 USD Billion
- South & East Asia: 161 USD Billion
- Latin America & Caribbean: 117 USD Billion
- Central & Eastern Europe: 80 USD Billion
- Japan & Industrialized Asia: 80 USD Billion
- Oceania: 50 USD Billion
- Middle East & Central Asia: 20 USD Billion
- Africa: 10 USD Billion
GROWTH IN AGRICULTURAL INSURANCE PREMIUMS 2005-2009

Source: Global Premiums Iturrioz, 2010

US$ Billions

Source: Global Premiums Iturrioz, 2010
IS THE INSURANCE STILL A GO-TO-TOOL FOR THE MOST VULNERABLE AND POOR?

- High insurance costs
- High residual risks
  - Urban areas: Poorly developed risk mitigation options such as structural standards, land use/urban planning etc.
  - Rural/agriculture: Only 35-40% of Indian agriculture is irrigated.
- Poorly developed re-insurance industry
- Poor availability of data to assess risks for designing risk insurance systems (e.g. weather data and data on crop loss)
- Willingness to pay: Cultural and perceptual issues with both people at risk and policy makers

Given these limitations, should we still be thinking insurance as a go-to-tool for the most vulnerable? What are the alternative financial risk management approaches can we think?
WHAT WE WANT TO UNDERSTAND IN THIS WORKSHOP?

- With the above context, the following questions deserve in-depth examination:
  - Are insurance instruments designed keeping in long-term objectives in mind? What are long-term evidences we have?
  - Is there any evidence for farmers adopting more robust risk mitigation options to reduce premium prices?
  - How do we know that insurance is resulting into disaster risk reduction and climate change adaptation outcomes?
  - What indicators and methodologies can we pick to assess insurance products for their CCA and DRR benefits?
  - What insurance design elements and monitoring and evaluation procedures can ensure such benefits for various stakeholders engaged in insurance?
  - Does the slow pace of progress in up scaling insurance in developing countries hint for alternative risk management options? If so, what they would be?
THANK YOU!

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