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Risky business: insurance against extreme weather is no panacea

Authorities are looking into ways of mitigating the effects of natural disasters and protecting the people who are hardest hit

Read this article in German

In the past 20 years, there have been more and more extreme weather events around the world. The most affected tend to be poorer countries in the Global South – the people who can least afford to deal with the damage caused.

In September 2017, Hurricane Irma wreaked havoc in the Caribbean. Thousands of people lost their homes; up to 95 per cent of the buildings on the island of Barbuda were damaged or destroyed. Such events also cause serious financial damage. In 2016, Hurricane Matthew caused economic losses amounting to one-fifth of Haiti's gross domestic product – money that is needed for healthcare, education and rural development. According to global climate forecasts, developing and emerging countries should prepare for more, even stronger extreme weather events. These are sure to threaten the livelihoods of entire population groups.

One possible measure to protect developing countries against this threat is climate risk insurance, which offers coverage in case of natural disasters. Countries pay annual premiums to public-private regional insurance companies, and receive specified, standard payouts in case of catastrophe. Unlike conventional insurance, no one is dispatched to assess the damage and estimate the costs. Instead, the insurance company projects the damage by using real-time meteorological and satellite data, and makes payments once a particular threshold value is reached. Such a configuration facilitates rapid payouts – usually within 14 days – and lowers administrative costs, as well as annual premiums. However, computer modelling may under- or overestimate the damages.

Getting help, faster

Climate risk insurance guarantees rapid assistance. In the past, developing countries were forced to be petitioners. Often incredibly poor with no way to put any money aside, they had to request help from wealthier countries after disaster had struck. While rich countries are not deaf, they usually promise a lot, pay much less and set rigid guidelines for assistance that may not address local needs. Furthermore, funds only arrive after many months. In such cases, climate risk insurance can provide relief. Guaranteed payments make it possible for countries to better help their affected populations by more quickly undertaking emergency relief and reconstruction measures.

In this respect it is no surprise that climate activists, NGOs, insurance companies, development banks and the German federal government are all enthusiastic about climate risk insurance. Germany's Federal Ministry for Economic Cooperation and Development (BMZ) has supported these tools from the start. At the World Climate Conference in Bonn in November, the BMZ helped launch InsuResilience, 'a global partnership to enhance financial protection against climate risks', and made €110 million available for developing insurance schemes. Other G20 members and development banks are also offering support. In the field of climate adaptation, climate risk insurance is hailed as a big innovation.

But is such insurance really as effective as people like to claim? A closer look suggests that it is not. While climate risk insurance definitely has a place in catastrophe management, its benefit has not yet been proven beyond doubt and depends very much on its design.

A drop in the ocean

Payouts are prompt but their benefit is not proven. Even funds that are paid quickly don't necessarily help the countries that get them. On one hand, the amounts are much too small: to date, payouts have ranged between $200,000 and $26 million. In the wake of Hurricane Maria in October 2017, the island of Dominica received the agreed $19 million from the Caribbean Catastrophe Risk Insurance Facility within 14 days. However, World Bank estimates put the total damages in Dominica at around $1.3 billion – approximately 224 per cent of the island's GDP. Compared with the total losses, $19 million is barely a drop in the ocean – just enough to pay for first aid. In fact, that's exactly what climate risk insurance is for. But this is often forgotten in public discussions.

Such insurance policies offer no comprehensive coverage; at best, they offer very limited basic protection. This means that with or without

climate risk insurance, developing countries still depend on substantial solidarity and aid from abroad for reconstruction. The World Bank is currently preparing a financial package of around $100 million for Dominica. That, too, is far from enough. Countries struck by disasters continue having to act as supplicants and rely on traditional financial tools such as loan conversions and relief funds.

Furthermore, there is nothing to show that the payouts made so far have reached the people who needed them. So far, the hopes placed in climate risk insurance by the G20 and other enthusiasts are based on assumptions. Of course, trust is good. But monitoring is much, much better. Climate risk insurance is new, and policymakers can't always wait for scientific certainty before they test new tools. But since no insurance market exists outside the OECD, creating and developing climate risk insurance is costly and time-consuming. Not only is there no data or regulation, but insurance itself is also not generally understood. The resource-intensive creation of climate risk insurance using taxpayer money – G20 countries have made available around $550 million in development funds for this – should be worth the effort. We are waiting for reliable evidence that it is.

Who gets money, and how?

Even when climate risk insurance policies ensure prompt payouts, rapid first aid and reconstruction are not guaranteed by rapid payment. Governments still have to meet and decide how to use the funds. Each ministry has its own wish list and wants a big slice of the cake, and while this process is completely legitimate, it may take too much time.

To ensure that assistance arrives at the proper destination quickly, institutional structures must be created to determine whom to help with how much money and how. Ministries could agree in advance on general emergency measures to be covered using the first funds. These can be adapted to local needs and conditions. Beyond that, a central authority such as the office of national disaster control could be delegated to release the funds and implement the measures, in consultation with local authorities. In this respect, the African Risk Capacity is setting a good example. It requires each country to submit a general action plan elaborating how the funds will be used in case of a major emergency. However, regional insurance companies in the Caribbean and Pacific, like the Pacific Catastrophe Risk Assessment and Financing Initiative, are not yet setting such conditions. In other words, climate risk insurance only really adds value when it is an integral part of a national catastrophe management system.

What are the alternatives?

Social and climate adaptation programmes can provide similar, and perhaps cheaper, better and more sustainable, contributions to catastrophe management. Social housing can help prevent people from settling in dangerous areas, thereby making a major long-term contribution to disaster preparation. A public employment scheme for building dams and dykes can limit the negative effects of torrential rains and droughts, while social transfer programmes that use cash cards or mobile phones to make direct payments upon extreme weather alerts can help guarantee emergency supplies and reduce the risk of corruption.

Climate risk insurance is no panacea. In any case, it won't prevent social catastrophes. Saving lives and effectively limiting future damage requires much more basic measures: namely, massive investments in disaster preparedness, as well as the creation and development of comprehensive social security systems.



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