



# Climate risk insurance for smallholder farmers

A UK Parliamentary report on behalf of the All-Party Parliamentary Group on Agriculture and Food for Development.

October 2017

## About the APPG

The APPG on Agriculture and Food for Development brings together Parliamentarians concerned with agriculture, nutrition and food security in the developing world. It was established in October 2008 in response to growing concerns over heightened food prices and a chronic underfunding of agricultural development by bilateral and multilateral organisations and national governments. Chaired by Jeremy Lefroy MP and co-chaired by Lord Cameron of Dillington, the APPG is a cross-party initiative drawing members from both Houses of the UK Parliament.

## Introduction

Climate change is taking a disproportionate toll on poor rural people in developing countries. The majority of them are small-scale farmers, and they have always led a precarious existence, relying on established local weather patterns to achieve one or two harvests per year. With droughts, heatwaves, storms and floods becoming more common, their livelihoods are increasingly under threat.

When weather shocks occur, these farmers are the least able to cope and are easily dragged into extreme poverty and food insecurity. It is important that those most vulnerable to the effects of climate change are helped to build resilience to its impacts. If they are not, tens of millions of people may be pushed back into extreme poverty by 2030, undoing improvements of recent years and undermining progress towards the Sustainable Development Goals.<sup>1</sup>

Target 1.5 of the SDGs specifically aims to “build the resilience of the poor and those in vulnerable situations and reduce their exposure and vulnerability to climate-related extreme events and other economic, social and environmental shocks and disasters”.

Insurance can play a critical role in achieving this resilience among small-scale farmers. When used appropriately, it can protect people from falling into extreme poverty after climate shocks. Small-scale farmers are instinctively risk-averse, as the wellbeing of their entire family often depends on their crop yields. The security of insurance can also encourage farmers to invest more into their own productivity through modern seeds and crop varieties, and move beyond low-risk, low-return activities. Well-designed insurance also incentivises greater adoption of farming practices that mitigate against climate change, if they lead to lower premiums for example.

It is important, however, to deploy insurance judiciously within an overall risk management strategy for small-scale farmers. Insurance is not an appropriate response to all of the multitude of risks faced by poor people, and it should not replace other ways of building resilience to climate shocks – through improved agricultural practices, for example. But when used appropriately, insurance can provide a valuable safety net and transform the livelihoods of the poorest people.

### How does climate risk insurance work?

Climate risk insurance is a way of compensating farmers when specific climate-related events occur. Traditionally, agricultural insurance – like other forms of insurance – would pay out based on individual losses or damage to crops and livestock.

But assessing loss and damage for millions of individual small-scale farmers in developing countries after a weather event is impractical and would make premiums unaffordable. That's why 'index' or 'parametric' based insurance has emerged as an alternative, so that individual assessment isn't necessary.

Instead, pay-outs are triggered based on an index or set of parameters, such as rainfall or temperature within a defined place and time. The data is gathered by weather stations, satellites and mobile phones, and the pay-out is made automatically when the measured conditions fall above or below a certain threshold. Individual losses and damage do not need to be assessed, making transaction costs lower and pay-outs quicker.

#### **In practice, climate risk insurance provision is structured at three broad levels:**

**Micro-level insurance.** This is a form of direct cover, where individual farmers will hold their own policies and receive pay-outs. One example is the Agriculture and Climate Risk Enterprise (ACRE), an index insurance scheme operating in east Africa, specialising in crop insurance sold directly to farmers.

**Meso-level insurance.** This is a form of indirect cover. Organisations such as local banks, cooperatives or NGOs might hold the policy on behalf of individuals they provide services to.

**Macro-level insurance.** This sovereign level insurance is another form of indirect cover and one which has received a lot of donor attention and support. National governments (or national-level agencies) hold the policy, and a pay-out enables them to direct assistance to those who need it. Two well-known examples are the Africa Risk Capacity and the Caribbean Catastrophe Risk Insurance Facility.

### Potential benefits of climate risk insurance

Insurance can help farmers cope with the adverse effects of extreme weather events by paying out relatively quickly after the event (in comparison to other forms of financial support, such as disaster appeals). It also provides incentives for strengthening resilience prior to any disaster, and security for farmer-driven investment into valuable new markets or inputs such as improved seeds and fertilisers.

In evidence provided to the APPG by RESULTS UK and Bond, the potential benefits of climate insurance were described as Preventive, Promotive and Transformative.

**Preventive:** Because prompt payments buffer poor people from economic losses and prevent them from falling into extreme poverty. Without that safety net, sudden shocks can lead to the forced selling of important assets (such as livestock) as a coping mechanism in emergencies, which then makes it much harder to recover.

**Promotive:** Because having insurance can foster a "space of certainty" so that farmers can plan and invest. Farmers are more likely to move into new and higher value crops, for example, which can accelerate progress out of poverty. Insurance can provide the security to unlock that process.

**Transformative:** Because insurance requires processes and systems to measure the risk of loss and damage. Designed well, and implemented at scale, insurance products can incentivise widespread climate change mitigation and increase overall resilience, by linking premium costs to risk-reducing measures, for example.

Evidence given to the APPG inquiry by Hector Ibarra, Chief Executive Officer at Global Parametrics, stated:

***Financing the recovery of households, SMEs and communities falling victim to natural disasters is too often ad hoc, belated and dependent on unreliable charitable contributions that do little to build resilience. Financial products better suited to meeting the needs of these vulnerable communities are being designed and becoming increasingly available, including risk transfer to developed markets.***

## Current political momentum

Political support for climate risk insurance has grown steadily in recent years. In June 2015, Germany – under its G7 Presidency – launched the ‘InsuResilience’ initiative: a commitment to increase climate risk insurance protection to an additional 400 million people in developing countries by 2020. At the 2015 United Nations Climate Change Conference in Paris, G7 countries reaffirmed their support for the project by pledging \$420m; this amount was increased to \$550m at the Marrakech summit in 2016. Germany and the UK have taken leading roles in InsuResilience, pledging the largest financial resources.



Most recently, at the G20 meeting in Hamburg in July 2017, Prime Minister Theresa May announced a new London Centre for Global Disaster Protection, in partnership with the World Bank Group, which will provide a hub for leveraging UK risk, science, insurance and reinsurance expertise. The UK will provide up to £30m of support for the London Centre, most of which will be spent on providing expert advice and developing scientific responses for managing risks.

The London Centre will also develop a pilot programme involving the provision of grants to some of the poorest developing countries as a way initially to fund insurance premiums for them, but with a view towards those countries becoming self-sustaining in their use of insurance protection against climate risks.

## Recommendations

These developments show that risk transfer is becoming an integral part of resilience strategies for those most vulnerable to climate change. Used well, it can help ensure that weather events do not undo years of development progress.

But climate risk insurance is still a new sector, and it can cover a vast array of products and forms of delivery. Its helpfulness in building resilience will depend very much on how it is structured, and the extent to which emerging global partnerships and policy retain a focus on the poorest people, and towards providing policies which are appropriate and affordable to them.

This APPG inquiry therefore recommends that donors and policymakers observe the following recommendations. These are not exhaustive, but are some of the key points that have emerged from the evidence-gathering and research for this inquiry.

### 1. Do not view insurance as a silver bullet

Climate risk insurance is only appropriate for recovering the loss and damage from infrequent, unpredictable and severe weather events. It isn't applicable to frequent events or to slow-onset changes, such as sea levels or erosion. It is therefore crucial that investment in insurance doesn't divert funding or attention away from other ways of building resilience to the impacts of climate change, such as agricultural adaptation, livelihood diversification and social safety nets. Donors must see insurance as one part of a wider adaptation strategy, and not a replacement for it.

### 2. Bundle insurance with other products and services

Smallholders face many risks, not all of them directly related to climate change. Research suggests that bundling insurance into other products and services such as training, inputs and financial inclusion programmes increases uptake<sup>2</sup>. At the APPG's evidence session on 18 July 2017, VisionFund's Global Insurance Director, Stewart McCulloch, explained that the organisation is currently scaling up a new model of multi-peril crop insurance products (going beyond weather to include other

risks too) aimed at groups of smallholder farmers. The insurance is provided as a package with credit and agricultural advice.

VisionFund told the APPG that insurance can and should be offered to farmers as an input alongside other inputs and types of support, but that it must also be specifically targeted to local risks. “Our clients are smart, and typically use six to ten financial products in any year, so you have to exactly meet their needs,” said McCulloch.

### **3. Ensure trust, transparency and accountability**

Donors have a role to play in helping countries establish regulatory frameworks for new and evolving insurance products. By collaborating with the insurance sector, they can help ensure good governance and public information to establish trust. This trust and associated protection will be important in markets where the policyholders or beneficiaries are already amongst the most vulnerable in the world.

### **4. Maintain principles of equity and accessibility**

One of the ‘pro-poor’ principles put forward by RESULTS UK is that of accessibility. Giving evidence to this inquiry, Executive Director Aaron Oxley said: “There will be very poor people who cannot buy insurance on a commercial basis. We would

argue for there to be long-term investment from countries responsible for generating climate change to help subsidise the long-term sustainability of the response, and this fits under the United Nations Framework Convention on Climate Change.”

In practice, this might mean helping to cover at least some of the cost of premiums to ensure protection for the very poorest, recognising that this might be a better use of donor support than other financial responses, such as cash transfers after the event.

### **5. Balance macro, meso and micro level approaches**

There is a risk of donors and development partners focusing too heavily on sovereign risk pooling such as the Africa Risk Capacity and Caribbean Catastrophe Risk Insurance Facility. The InsuResilience initiative has called for a quarter of the target (100 out of 400 million people) to be reached through direct insurance, and it will be important to sustain efforts towards achieving that balance. Different models are appropriate for different contexts. Insurance can be delivered effectively at the meso level through cooperatives and self-help groups, for example. Micro-insurance for individuals may be appropriate for local and lower-threshold climate shocks, which do not trigger at the relatively high threshold of macro-level models.<sup>3</sup>

1. Hallegatte, Stephane; Bangalore, Mook; Bonzanigo, Laura; Fay, Marianne; Kane, Tamaro; Narloch, Ulf; Rozenberg, Julie; Treguer, David; Vogt-Schilb, Adrien. 2016. *Shock Waves : Managing the Impacts of Climate Change on Poverty. Climate Change and Development*, Washington, DC: World Bank.
2. Muller, S., Ramm, G. & Steinmann, R. 2014. *Agriculture, Microinsurance and Rural Development. Luxembourg: Microinsurance Network.*
3. Reeves, J and Richards, J. *Finance for Loss and Damange.* 2016. London: Bond.

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#### **Further information**

##### **InsuResilience: the G7 climate risk insurance initiative**

[www.insuresilience.org](http://www.insuresilience.org)

##### **Munich Climate Insurance Initiative**

[www.climate-insurance.org](http://www.climate-insurance.org)

##### **WINnERS (a joint climate risk insurance project between Imperial College London, the University of Reading, Ecole Polytechnique, and the University of Hamburg)**

[www.winners-project.org](http://www.winners-project.org)

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