PRINCIPLES AND CONDITIONS ON PREMIUM SUPPORT FOR CLIMATE AND DISASTER RISK INSURANCE UNDER PILLAR III

1. PREAMBLE

COVID-19's coinciding impact with natural disasters highlighted again the vulnerability of developing and emerging countries and the pondering effect of the large protection gap governments, small and medium enterprises as well as households in these countries are facing. With the financial burden of the pandemic the need for a broader discussion on premium support and with it the need for consensus about the use and design of premium support for climate and disaster risk insurance became apparent.

In accordance with the Principles on „Smart Premium and Capital Support: Enhancing Climate and Disaster Risk Finance Effectiveness Through Greater Affordability and Sustainability" (PCS), set out in the policy note adapted by the High level Consultative Group (HLCG) of the InsuResilience Global Partnership in October 2021, this paper reflects a set of overarching principles on the use and provision of premium subsidies by the InsuResilience Solutions Fund (ISF).

Forming common principles on how premium subsidies should be designed, the HLCG agreed that PCS should be provided and used in a manner that ensures:

- S: **S**ustainable Impact For The Most Vulnerable
- M: Value for **M**oney
- A: **A**ccessibility
- R: **R**esilience-building incentives
- T: **T**ransparency and Consistency

Following the overarching guidance of the PCS, the principles stipulated in this paper give guidance on the operational level, in order to ensure consistency of ISF premium support across different projects within the programme as well as across other implementing programmes under the InsuResilience Global Partnership.

The principles outlined here represent the conditions and terms under which projects applying for premium support of ISF are assessed on an individual basis and premium support being granted.

2. REASONS FOR PUBLIC SUPPORT FOR INSURANCE PREMIUM

As with other public market interventions premium subsidies are intended to overcome existing market failures and inefficiencies as well as to ensure the achievement of broader policy goals.

Climate and disaster risk insurance is a new and unknown financial product to the poor and vulnerable population, which may come at a high expense relative to the individual´s income.

At the same time, the costs of not having an insurance cover often results in much higher costs in case of an adverse event. To ease the introduction and upscaling of such novel insurance products will thus benefit by subsidizing the price for insurance, so that the target group is more likely to buy such cover and will appreciate its value.

3. CONSISTENT USE OF PRINCIPLES ON PREMIUM SUBSIDIES ON DIFFERENT LEVELS

When implemented the requisites of efficient and effective use of public funding and subsidiarity of public interventions with regard to market solutions, should guide the use of premium subsidy such that the wider policy goals can be met and market failures overcome with the least public funding needed. Principles on premium subsidies will thus be governed by these overarching objectives.

Efficiency and effectiveness of premium subsidy in the context of climate and disaster risk insurance stipulates a consistent use of this instrument on 3 different levels, i.e. on the

a) **program level** - coherent support of projects within the same support program (all projects within IIF PSF, or all projects within ISF receive premium support according to the same criteria)
b) **intra - instrument level** - coherent support across different program supporting insurance products as an instrument of climate and disaster risk finance (CDRFI) (all projects e.g. within IIF, ISF, GRIF and other programs offering premium subsidies for insurance products receive premium support according to the same criteria).
c) **inter - instrument level** - coherent support across different climate risk support instruments implemented within CDRFI (consistent and non-distortionary effects level of financial support is ensured to projects across different instruments offered under the IGP independent whether they are benefiting e.g. from capitalization of risk pools via equity of loans, premium support or contingent credit.)

With ISF offering premium subsidies for climate risk insurance products and thus representing support for climate risk insurance as an instrument of CDRFI, these principles are established to ensure consistency of premium subsidies on the program level of ISF as well as the intra-instrument level (level a & b above).

Consistency of premium subsidies offered across different CDRFI instruments (level c) will require a broader dialogue and development of a set of indicators measuring e.g. the level on concessionality and potentially other measures that would enable a comparison of financial support by the respective instruments. This third level of consistency is therefore not addressed in this paper.

4. PRINCIPLES AND CONDITIONS FOR THE PROVISION OF PREMIUM SUBSIDIES

The principles set out in this paper represent conditions that must be fulfilled in order for a project to be considered for premium subsidies (Part A) as well as concrete terms and conditions for the provision of premium support itself (Part B). The latter is monitored in the course of implementation.

A) Conditions precedent for the provision of premium subsidies

S Sustainable Impact For The Most Vulnerable - Pro-poor focus
Beneficiaries of the subsidized insurance products need to be poor and vulnerable (according to the InsuResilience target group, living on less than 15 USD ppp/ day) if the product is not used to partly replace the traditional disaster relief. In the case of the latter, at least 50% of potential beneficiaries need to belong to the InsuResilience target group.

M Value for Money - Convincing rationale for the use of premium support
Each specific project must be supported by a conclusive rationale for the use of funds for premium subsidies. Typical reasons for premium support include:

- Accelerate the uptake of the insurance product in order to achieve the necessary scale to help the product be sustainable (market failure addressed: high market entry/sunk costs);
- Uncertainty due to lack or poor-quality data on the loss probability of the insurance product (market failure addressed: information gap and or asymmetry);
- High fixed costs of product development which make the insurance products very expensive at the time of introduction (market failure addressed: high market entry/sunk costs);
- Incentives to insurance companies to invest into a new delivery channel (e.g. to cooperate with a microfinance institution, a local bank or a mobile communication company) for the first time (market failure addressed: market entry barriers);
- Subsidise insurance products designed with more frequent pay-outs (thus more expensive) with the objective to build the trust of the targeted customers in an initial phase, and subsequently move to products with lower frequency playouts, and thus more affordable (market failure addressed: lack of experience/trust on client´s side).

A Accessibility - Analysis of the willingness and ability to pay
In case of a Micro or Meso –level approach an analysis of the target customers' willingness and ability to pay must be carried out by the project partner in advance and the results submitted.

R Resilience-building incentives - Target-oriented use of funds
The funding provided for premium subsidies shall be target-oriented (e.g. geographic, categorical or study-based selection) , focusing on risks stemming from low-frequency and high-severity events to be transferred via insurance.

T Transparency and Consistency

- Suitable Business plan
  In case of a Micro or Meso-level approach a business plan based on dedicated assumptions (including growth forecast, scale-up assumptions, insurance premium components[1], product characteristics, etc.) must be submitted for the product in question (at least) for the duration of the premium support.
- Clear exit strategy
  As the sustainability of the promoted insurance scheme(s) is key, a path to sustainability and scale of the supported product(s) must be provided including a clear definition of a phase-out period. A clear exit strategy or long-term financing strategy needs to be presented.

[1] See Annex A

- Pre-agreed disbursement-plan
  Based on the business plan, the target and financial strategy, a project-specific disbursement plan has to be developed. The pre-agreed use of funds will be ensured through an M & E framework.
- Risk and Mitigation plan
  A premium support risks and mitigation plan must be developed that outlines expected risks associated with distributing premium support and how these will be mitigated. This can include, among others, aspects such as adequate treatment and payment of claims, competitive pricing/ no crowding out[2], no discourage of climate change adaptation measures, appropriate delivery channel.

B) Terms and conditions for the provision of premium support (subsidies) under Pillar III

The following terms and conditions shall apply for the use of funds to subsidize premiums:

1. Maximum amount: Not more than 30 % of total funding request or up to 750,000 EUR per project. Generally, a maximum amount of subsidies granted should always be defined at the start of the project.
2. Maximum percentage of insurance premium subsidized: Not more than 50% of the total insurance premium.[3]
3. A suitable mechanism is presented ensuring that the beneficiaries of the subsidized insurance products are poor and vulnerable (according to the InsuResilience target group, living on less than 15 USD ppp/ day) and to validate that (potential) insurance payouts are received by the latter. If the product is used to partly replace the traditional disaster relief, at least 50% of potential beneficiaries need to belong to the InsuResilience target group.
4. A mechanism exists to allow beneficiaries to complain and raise concerns about their coverage.
5. Subsidized insurance product(s) shall cover events with a frequency of 5 or more years.
6. Time period: subsidies can be provided for the duration of the ISF project.
7. The project partner to receive the premium support shall show good governance and clarify roles and responsibilities of the involved positions and departments to deal with the premium support in order to avoid risk of fraud and facilitate transparent monitoring.
8. The risk and mitigation plan is updated regularly (at least once a year).
9. The project partner(s) provide all necessary information for a sound M&E.
10. The product is cost-efficient in terms of the composition of the insurance premium (i.a. risk based component and remainder).
11. No-objection on insurance policy wording or terms and conditions (incl. composition of insurance premium, see example in Annex A).
12. The composition of insurance premium is to be shared with other donors or entities providing premium support for the product in question.

[2] A particular focus in that context shall be given to sustaining adequate incentive structures that do not crowd out other providers of similar insurance products, in case there are any. The effects on the market and competitors (if any) of a potential provision of a premium support shall be assessed prior and if necessary, during a premium support project. Where material negative effects on the market or competitors are identified, the premium support shall not be initiated or be discontinued unless a conceptual change or other measures can mitigate these effects (see terms and conditions).
[3] A higher percentage can be deemed eligible in case of a Macro-level approach where at least 50% of beneficiaries belong to the InsuResilience target group.

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ANNEX A
COMPOSITION OF INSURANCE PREMIUM

Insurance product characteristics	
1) Coverage period:	
2) Risk / insured peril:	
3) Sum insured (in EUR):	
4) Annual average loss (AAL) or expected loss (historical or modelled, please specify):	
5) Annual Loss Limit (if applicable):	
6) Annual Loss Deductible (if applicable):	

5) Insurance premium*

	Premium amount	Financed by other donor	Financed by government	Finance by client or end-beneficiary	Funded by ISF
Total (in EUR)					
Share to total (in %)	100%				

* The insurance premium should not contain costs already covered by the ISF project (e.g. product development costs)

6) Composition of premium (C10)

	Risk based premium or net premium	Reinsurance costs or net cost of reinsurance	Expense loading	Others	Sum	
Total (in EUR)						“=C10”
Share to total (in %)					100%	