

Flash flood in Cainta Rizal, east of Manila, in September 2009. Climate change hits the poor in developing and emerging countries especially hard. There is growing interest in insurance-based solutions.



## Microinsurance and climate change — Hope for millions? Thomas Loster and Dirk Reinhard

Microinsurance can help the inhabitants of poor countries to protect themselves against climate change impacts. But it will not work unless the products are tailored to the needs of the individual regions.

The IPCC'S fourth status report, published in 2007, provided conclusive evidence of the link between global warming and the more frequent and intense occurrence of extreme weather events. Scientists warn that floods and droughts are going to increase, whilst coastal areas, river deltas and entire archipelagos are threatened by rising sea levels. The developing countries, which have virtually no system of insurance, will suffer most, and only 100 million people, less than 3% of the population of the 100 poorest countries in the world, are covered by microinsurance.

Despite these statistics, microinsurance is a fast-growing sector in the developing and emerging countries. According to the International Labour Organization (ILO), the number of microinsurance policies rose by 80% between 2005 and 2009 in Africa alone. Most microinsurance policies cover major life risks such as sickness or death, often in combination with a microloan. A number of special features will have to be taken into account if microinsurance is extended to cover climate change impacts.

One of these is that the extent of the areas affected by the different weather risks varies considerably. Whilst flash flooding on a stretch of river may involve a few hundred people, a tropical cyclone can affect hundreds of thousands and a severe drought several million. Each individual case requires a specific underwriting technique: from microinsurance policies, in the case of individuals, to insurance pools and catastrophe bonds. Microinsurance can soon reach its limits when a natural catastrophe occurs. If thousands of claims are filed simultaneously, this can decimate entire portfolios. Claims handling is a costly process and, given the low premiums involved, it can take years if not decades to recoup the losses. A further consideration is: What happens in the case of an agricultural microinsurance policy where the temperature or precipitation figures fall just short of the indemnity trigger? The insureds are then left to deal with all-too-evident losses on their own, causing people to lose faith in the system for years.

Not only microinsurance but also index insurance, weather derivatives and other covers face major challenges. The starting point is the assumption of liability, and this has to take into account both the risks themselves and unforeseen loss accumulations. The basic rule that applies here is that the greater the geographical spread and the longer the period of insurance, the better. Additional requirements are transparent conditions and claims handling. If loss payments are relatively frequent, this boosts the interest of the people concerned, helping insurance systems to achieve the breakthrough. Moreover, apart from the obvious administrative and financial challenges, microinsurance also has to address other special circumstances:

- As a rule, programmes taken straight off the drawing board have little chance of success. We must get the people at risk involved if we are to formulate solutions that meet their needs and requirements.
- People are less likely to accept microinsurance if there is too wide a gap between premiums and claims payments. It is essential they understand that high-frequency events are not economically insurable. This aspect will assume greater importance as extreme weather events become more frequent.
- People on low incomes are perfectly willing to pay for a key product. Their decision will be influenced not only by the amount of premium in absolute terms but also by the possibility of paying in instalments.

A number of microinsurance products broadly satisfying these criteria have recently been launched in the market. They include extreme flood coverage for a major city in Asia, tropical cyclone cover in the Philippines and cover against extreme winters in Mongolia. However, this does not alter the fact that microinsurance is still in its infancy.

The role of microinsurance was acknowledged by those taking part in the United Nations climate convention, as can be seen from the current Copenhagen Process. Now, it is up to the players – microfinance organisations, insurance industry, regulatory authorities, governments and donor agencies – to formulate viable solutions. However, it is clear that microinsurance alone will not be sufficient to mitigate the impact climate change will have on the poor. Mesoscale and macroscale solutions are also needed.

The path to global microinsurance may be a difficult one, but we must not falter. Climate change leaves us with no alternative.



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