

Nations Unies

Conférence sur les Changements Climatiques 2015

COP21/CMP11

Paris France

COP 21: Understanding insurance in the Paris Package

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1. COP 21: The Paris Package

On 12 December 2015, 195 negotiating Parties to the UN Framework Convention on Climate Change reached an internationally binding agreement with obligations for all Parties¹. Across a set of contested issues central to international climate policy. The broad theme of “comprehensive climate risk management” runs throughout the COP21 meetings themselves and the outcome document:

- **the root drivers of climate change risk** (mitigating greenhouse gas emissions) and historical responsibility—the agreement arguably sends a clear signal to governments and investors worldwide for “greenhouse gas neutrality” (the formal language used) of energy systems by 2050. The market signal noted in media headlines includes “end of fossil fuel era” and “phasing out of coal, oil and gas”. The agreement is
- **the impacts of climate-related risks** (adaptation, and a formal recognition of a new third pillar of climate policy called “loss and damage”)—the Paris outcomes include a global goal for adaptation, financial commitments and anchoring loss & damage in the agreement.
- technical and financial **means to achieve solutions** through new levels of action.

The final adopted document was designed to handle these questions purposefully, and to revisit them in regular cycles in the near future. The Paris package marks a historic milestone by any standard, the scope of which will guide a wide array of policies and actions spanning energy, technology, development, and humanitarian assistance.

2. Overall focus: building climate resilient sustainable development

In this report by the Munich Climate Insurance Initiative (MCII), “the Paris Package” refers to three sets of outcomes in Paris show in the figure below. The Paris package includes three parts: Decisions by the Conference of the parties (COP decisions) which direct the work of the Parties and the UNFCCC and

¹ Find complete text of Paris agreement: <http://unfccc.int/resource/docs/2015/cop21/eng/I09r01.pdf>

associated bodies, the legally binding Paris Agreement, and an additional “Lima Paris Action Agenda” (LPAA) framing significant initiatives that help move climate action forward.

The Paris Package



The Paris package includes three parts: COP decisions, and the Paris Agreement. Additionally, a “Lima Paris Action Agenda” provides a platform for state and non-state actors to demonstrate the commitment through short term and long term actions that will support the new legal agreement.

The adverse effects of climate change are not evenly distributed across the world because of differing exposures, vulnerabilities and coping capabilities². All countries will require pathways that lead to a more climate resilient development in the face of potentially growing weather extremes and incremental, profound shifts in natural systems, like sea level rise and desertification driven by climate change. Strategies are needed to manage unexpected shocks from weather extremes. These strategies should complement and facilitate the design of approaches to address longer-term incremental adverse effects of climate change. Because the risks often fall more heavily on those least able to reduce or recover from them, international and technical communities recognize the relevance of tools like insurance which enable avoiding, reducing and sharing the risks related to climate change³. The Paris package has several notable features relevant for discussions of comprehensive climate risk management, including insurance and risk transfer related tools.

3. Insurance in the COP Decision

Insurance-related approaches are featured in **paragraph 49** in the section on Loss & Damage, which is part of the COP decisions (see pages 4-20) that shall give effect to the agreement. Paragraph 49 requests the Executive Committee of the Warsaw International Mechanism (WIM) to establish a “clearinghouse for risk transfer” (see text box below). The clearinghouse is anchored in the WIM, and as will be seen in the next section, article 8 anchors the WIM in the Paris Agreement (PA). The paragraphs 48 – 52 of the COP decisions outline the roadmap for work in coming years on comprehensive climate risk management.

Paragraph 49 *49. Requests the Executive Committee of the Warsaw International Mechanism to establish a clearinghouse for risk transfer that serves as a repository for information on insurance and risk transfer, in order to facilitate the efforts of Parties to develop and implement comprehensive risk management strategies.*

² IPCC 5AR WG2 SPM

³ Article 4.8, Article 3.14, Bali Action Plan, CAF para 28(b), COP18, from Decision 7/CP.17

Analysis

It is notable that the focus of the clearinghouse for risk transfer should have two or more functions: (a) serve as a repository for information and (b) this information should facilitate efforts to develop and implement comprehensive risk management strategies. The ultimate focus on developing and implementing strategies is an advance building on past climate policy work such as the Cancun Adaptation Framework (COP16), the Doha Climate Gateway Decision (COP18), and the establishment of the WIM in Warsaw (COP19).

Insurance is recognized as essential tool to address loss & damage

Providing timely, targeted financial risk management to buffer against adverse climate impacts. Insurance helps reduce the *burden* of some kinds of climatic stressors, one of the major benefits of the approach. Financial risk transfer approaches that manage unexpected extremes can create a buffer (i.e. by providing financial liquidity through fast payouts immediately after a loss event). By spreading losses among people and across time, insurance reduces the catastrophic impact of some extreme weather events. *Timeliness and reliability of assistance.* A major advantage of insurance over post-disaster financing options, including aid, loans and family assistance, is its timeliness and reliability. In comparison with (usually) ad hoc disaster assistance, insured clients have a “right” to post-disaster compensation. Index-based contracts, which require no inspections for claim settlements, can in principle provide payouts immediately following the “triggering” event. Timely payouts enable households to buy food and necessities without resorting to selling household assets, and help governments avoid fiscal deficits and costly post-disaster loans.

4. Insurance in Art. 8 (Loss and Damage)

Over recent years, science (such as the IPCC Special Report on Extreme Events, and Chapters 16 and 19 of the IPCC 5th Assessment Report) has pointed to climate futures beyond 2 degrees above pre-industrial levels, and associated barriers and limits to climate change adaptation for a range of climate change scenarios. Policy responded to this growing realization by introducing the notion of residual climate risks and climate impacts, dubbed “loss and damage”. Article 8 of the Paris Agreement emphasizes the “importance of averting, minimizing and addressing loss and damage associated with the adverse effects of climate change” and introduces loss and damage as a “third pillar” of climate policy, alongside mitigation (avoiding dangerous climate change), and adaptation (adjusting to climate impacts). The inclusion of loss and damage in this article sends a signal that vulnerable countries will not be left alone with the consequences of climate change but supported in strategies to address loss and damage.

Article 8

1. *Parties recognize the importance of averting, minimizing and addressing loss and damage associated with the adverse effects of climate change, including extreme weather events and slow onset events, and the role of sustainable development in reducing the risk of loss and damage.*
2. *The Warsaw International Mechanism for Loss and Damage associated with Climate Change Impacts shall be subject to the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement and may be enhanced and strengthened, as determined by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement.*

Analysis

In the lead-up to Paris, it was contested whether there would be a separate recognition of loss and damage, apart from the theme of adaptation. Article 8 of the Paris Agreement constitutes a milestone in years of policy discussion and fulfills a central demand of the most vulnerable countries. The embedding of loss and damage in the agreement includes an institutional and a

substantive dimension that are complemented by COP decisions: The institutional dimension secures the future of the Warsaw International Mechanism and provides the foundation for its strengthening. For this purpose, the Warsaw International Mechanism is anchored in the agreement and the COP is mandated to expand and strengthen it.⁴

The implementation of the international agenda for loss and damage has **limitations**: Neither the Paris Agreement nor COP decisions contain specific commitments for Parties regarding financial support. It is noted that the Parties should enhance support for loss and damage-related activities. Additionally, due to the pressure of some developed country parties, paragraph 52 of the COP decision reads like an “exclusion clause”: provisions defined in article 8 of the agreement do not include or are a basis for liability or compensation. Particularly for the most affected countries this wording weakens solidarity package as no additional tools and support claims are defined, should mitigation and adaptation policies not go far enough. The COP decision does not exclude liability/compensation in a wider context (e.g. beyond article 8) and leaves room for the issue via different channels, should the temperature goal not be achieved.

A framework for signaling the magnitude, location, and exposure to climate-related risks.

Experience reveals multiple limitations of traditional forms of insurance¹: it does not prevent or reduce the likelihood of direct damage and fatalities from extreme weather events; it is not always the most cost-effective or affordable approach; and potential un-insurability associated with increasing frequency and magnitude of extreme weather events. These limitations have led to one of the most important insights for how this tool can contribute to addressing the adverse effects of climate change: Insurance can be embedded in a comprehensive climate risk management system which utilizes risk assessments, risk reduction, and ex ante planning for how insurance payouts will be applied. A combination of measures that includes insurance can reduce maladaptation, and reduce immediate losses and long-term development setbacks from adverse climatic impacts.

In such a framework, insurance is not solely a tool that organizes financial risk, collects premiums, and makes payouts. Risk assessment is a core function of insurance approaches¹. It brings attention to the hazard potential, the exposure and vulnerability, and in this way it can raise awareness and expose new options for managing the risks¹. The prerequisites of insurance—including hazard maps and risk information; appropriate regulation, building codes and zoning, and consumer protection; and financial adequacy—can catalyze the anticipation and management of adverse climate impacts

Insurance language appears in paragraph 4 of article 8, where major areas for Parties to enhance understanding, action and support are highlighted.

Article 8

3. *Parties should enhance understanding, action and support, including through the Warsaw International Mechanism, as appropriate, on a cooperative and facilitative basis with respect to loss and damage associated with the adverse effects of climate change.*
4. *Accordingly, areas of cooperation and facilitation to enhance understanding, action and support may include:*
 - (a) *Early warning systems;*
 - (b) *Emergency preparedness;*
 - (c) *Slow onset events;*
 - (d) *Events that may involve irreversible and permanent loss and damage;*
 - (e) *Comprehensive risk assessment and management;***
 - (f) *Risk insurance facilities, climate risk pooling and other insurance solutions;***
 - (g) *Non-economic losses;*
 - (h) *Resilience of communities, livelihoods and ecosystems.*

⁴ Art. 8, para. 2

Paragraph	(e) Comprehensive risk assessment and management
Analysis	Insurance-related approaches are designed for managing losses and damages caused by events which cannot be foreseen where and when they occur. Insurance is used to address impacts associated with extreme weather events (unforeseen storms, floods, droughts, temperature extremes). Insurance is not generally feasible for slowly developing and foreseeable events or processes that happen with high certainty under different climate change scenarios ¹ . Experience shows that insurance is best applied in conjunction within a comprehensive risk management framework including risk assessment, early warning, risk reduction, risk transfer, and rehabilitation. Even for weather-related events, insurance is not optimal for large events that occur with very high frequency, such as recurrent disastrous flooding. Resilience building and prevention of loss and damage in such instances can be cost effective ways to address these risks.
Paragraph	(f) Risk insurance facilities, climate risk pooling and other insurance solutions
Analysis	Insurance covering extreme weather events can be provided at different scales: for households (e.g. micro-insurance), groups or institutions (e.g. credit unions, savings pools sometimes linked to microfinance), provincial levels, and sovereign levels, and sovereign pools at the regional level. Weather-related insurance can cover a variety of values at risk: traditional (indemnity-based) market-based products include crop insurance and property insurance (houses, vehicles, public infrastructure); newer “hybrid” insurance approaches include the use of parametric insurance, and are covering livelihoods sensitive to weather (farmers, herders, fisherfolk), food security (some linked to social safety net programs), and ecosystems (coral reefs, mangroves).

5. Insurance in the Lima Paris Action Agenda

At the historic Climate Conference COP21 in Paris, G7 leaders join other Heads of State to point the way to climate-resilient development pathways. During the Action Day of the Lima Paris Action Agenda, G7 Leaders and Partners announced the Rapid Action Package of G7 InsuResilience⁵. G7 States pledged USD 420 million to support the implementation of InsuResilience in its ultimate objective to increase the availability of risk transfer and insurance solutions for poor and vulnerable people by 400 people by 2020. The rapid action package presented under the Lima Paris Action Agenda days aims to cover around 180mio people through scaling up of ARC, CCRIF, strengthening PCRAFI, and KfW’s Climate Insurance Fund in 2016.

6. Ways forward

The Paris outcomes mark a milestone in climate policy, and a milestone in thinking of climate change in a risk management paradigm. With the text introduced in the COP decisions (insurance clearinghouse) and Paris Agreement (facilities, insurance solutions) and the G7 InsuResilience Initiative, the stage is set for five years of preparation and implementation of insurance solutions that explore new opportunities (such as how to reach currently underserved populations) and challenges (rethinking insurance approaches, capturing technology and ways to reduce costs while ensuring risk adequate premiums). The yardstick of climate risk management success between 2016 and 2020 when the Paris Agreement comes into legal force will include a) credible, business-quality plans for implementation of risk management b) national planning that assesses and maps climatic risks, links incentives for risk reduction, and risk transfer where appropriate and c) implementation of new risk management schemes that include insurance to assist vulnerable countries and people. In conclusion, MCII will continue to follow policy and action related to climate risk insurance for vulnerable people and countries, from 2016 and beyond. Congratulations to everyone for the results of your hard work and effective leadership. Wishing you a happy holiday season at the end of this historic year.

⁵ At the event, BMZ presented the rapid action package for InsuResilience. Please find the **joint statement** for InsuResilience here: http://www.climate-insurance.org/fileadmin/mcii/pdf/COP-21/Joint_Statement_G7_InsuResilience.pdf