Unlocking Investment De-Risking Strategies for Climate Adaptation Finance

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Adaptation Finance Gap

- The current adaptation finance gap is now estimated at USD 194-366 billion per year
- priorities, per year this decade
- Adaptation finance reached an all-time high of USD 63 billion in 2021/2022
- Businesses should be interested in adaptation:

 - Growing ESG expectations



Cost of adaptation estimated at USD 215 billion and USD 387 billion needed to implement domestic

BUT remains dominated by public actors (98%), with fragmented flows from the private sector

• Up to \$1 trillion at risk over the next five years for the world's 215 biggest firms due to climate impacts

Sources: https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/ https://climatechampions.unfccc.int/what-it-takes-to-attract-private-investment-to-climate-adaptation/ https://www.unep.org/resources/adaptation-gap-report-2023





Reasons the private sector is hesitant to invest

Perception that there is no money to be made

- Might result in public benefits rather than direct financial returns

Information asymmetries and knowledge gaps

- Uncertain financial value of many adaptation measures ٠
- Lack of systematic measuring of impacts or calculation and monetization of potential environmental and social benefits
- Challenges to reliably calculate returns on investment and make informed investment decisions

Investment horizon and size of adaptation projects

- Long-term nature of 10-20 years of implementation
- Potentially large upfront costs against relatively long payback time
- Often small ticket size



Adaptation projects may be perceived as riskier due to the uncertainty and complexity of climate impacts







Some risks to be considered

- Sovereign risk
- Political risk
- Business or project risk
 - Climate and disaster risk
 - New technologies
 - (Lack of) financial records
 - Commercial business model
 - . . .
- Foreign exchange rates
- + A financial cushion against unexpected losses

 \rightarrow Often results in a high risk-premium for adaptation projects





How to address these risks?

- Perceived vs. actual risk
 - Access to expertise and prior experiences in investing in certain contexts can reduce perceived risk
- Risk management
 - Risk must be mitigated, transferred, or borne
 - Important to analyze which specific risk is holding back private investments and design a targeted intervention for each program/project







De-risking options

- Blended finance
 - further private investment
 - the initial risk or first loss.
 - commercial deployment.
 - An innovative example: <u>Global Fund for Coral Reefs</u>
- Insurance/reinsurance
 - Allocate the risk to the parties best placed to manage it risk transfer to insurers.
- Public Private Partnerships (PPPs)
- **Technical Assistance**
 - Climate Risk Assessments
 - Feasibility Studies
 - Capacity Building and Training
 - Pipeline development
 - ...
- Policies, regulations and fiscal incentives



Guarantees, co-financing, risk-tolerant capital (e.g. first loss equity or risk-absorbing junior debt layer) aimed to unlock Catalytic funding (often public) enables the development of innovation, pilots, and proof of concepts. This also absorbs Private sector funding instills the appropriate governance and assurance to shift the mindset from experimentation to

Sources: https://www.climatepolicyinitiative.org/blog-ways-to-de-risk-climate-finance/ https://www.wri.org/paying-for-paris/shifting-and-mobilizing-private-finance# https://climatechampions.unfccc.int/what-it-takes-to-attract-private-investment-to-climate-adaptation/ https://www.swissre.com/australia_newzealand/insights/leveraging-collaborative-models-to-de-risk-andcommercialise-innovation.html

https://www.climatepolicyinitiative.org/de-risking-through-ecosystem-building/





Climate and Disaster Risk Finance and Insurance (CDRFI) - Contributions to Adaptation

- Secure Adaptation Investments
 - Climate and disaster risk is transferred to insurers
 - Fast reconstruction and restart of activities
- Encourage Investment
 - Peace of mind for investors, both large and small (e.g. Farmers investing in resilient techniques)
 - Often a necessary requirement
- Improved Data and Analytics
 - High-quality data and models are necessary for product development
- Collaboration Between Public and Private Sectors
- Incentives for Disaster Risk Reduction and Adaptation
 - Risk Reflective Pricing

• ...







CDRFI in NAPs – Analysis (1)



CDRFI in NAPs (out of 54 analyzed) Insurance Any Other **Risk Transfer Risk Pool Contigency Fund** Action items **Decriptive Elements**

Level of CDRFI integration





Source: UNDP (forthcoming): Climate and Disaster Risk Finance and Insurance in National Adaptation Plans and Nationally Determined Contributions. Analytical Report.





CDRFI in NAPs – Analysis (2)

Hazard addressed by **CDRFI** solution

Drought Heavy Rainfall

Fires

Flood

Tropical Storms / Strong Winds

Storm Surge

Heatwave

Most instruments do not specify the hazards



Sector addressed by Agriculture **CDRFI** solution

Business

Vulnerable Populations

Livestock

Infrastructure

Fishery

Settlements/Housing

Many countries do not specify sector







Roadmap to Integrate DRF into NAPs

Situation Analysis	NAP Formulation
Stocktake on:	 1.Institutional Arrangements and NAP developm • Establish Institutional Framework
1. Adaptation	 Legal Mandate for Adaptation Planning
Planning	 Generate Broad Interest in the NAP process Seek GCF NAP support
2. Interlinkage of Adaptation with Disaster Risk Finance	 2. Risk analysis and probabilistic risk modeling Risk Assessment and Modelling Identify key assets and climate scenarios
	3. Prioritizing cost-effective options
3. Disaster Risk	 Long list adaptation options
Financing	 Quantify costs and benefits
	 Develop business case
	4. Comprehensive Finalization of the NAP
	Consider Macro-Economic perspective
	Consider Inclusion and resilience of vulnerable
	Include CDKFI In Sectoral Priorities

Strengthening the enabling CDRFI environment
 Capacity Building Across and Within Sectors and Institutions



Source: UNDP (forthcoming): Integrating Disaster Risk Finance into National Adaptation Plans. Supplementary Guidelines.

	NAP Implementation	NAP Review
oment	 1. Identify activities and potential stakeholders for CDRFI 2. Mobilize Finance Find finance gap Explore external funding opportunities Prepare concept notes/proposals 3. Mainstream NAP into the Country's Sectoral Plan 	 1. Develop MEL framework and Adaptation indicators 2. Review and Update NAP
	4. Strengthening Collaboration with Private Sectors	
le group	Note: This is also applicable to a country with little or no CDRFI elements in the NAP	

Cross-Cutting



Challenges for CDRFI in NAPs and beyond

- Data availability and quality
- Product development costs
- Regulatory and legal framework
- Cost and affordability
- Expertise and knowledge
- Market awareness and consumer education
- Understanding and trust
- Scalability
- Novel problems and products
- Lack of CDRFI products
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Example: Increasing insurance protection in climateexposed countries

Challenges: Regulatory environment, data availability, expertise and knowledge, scalability ...

- The **Tripartite Programme**, financed by BMZ, brings together UNDP and 20 of the largest global insurance companies under the framework of the Insurance Development Forum (IDF).
- The aim is to develop risk finance solutions in 20 countries.
- UNDP implements a comprehensive **technical assistance** program in each country:
 - to ensure the risk finance solution is integrated into governance and long-term development planning.
 - to integrate climate risk analysis and modeling into key development processes, such as national development plans, regional plans, NDCs, and NAPs.
- UNDP offers project management support and leverages its country offices as active partners with governments to support these efforts.





Example: Climate Risk Adaptation and Insurance in the Caribbean (CRAIC)

consumer education ...

- MCII and CCRIF SPC are implementing a Climate Risk Adaptation and Insurance project in five Caribbean countries (Jamaica, Saint Lucia, Grenada, Trinidad and Tobago, and Belize).
- The project helps a private insurance company (Guardian Insurance) to provide an affordable insurance product for low-income and vulnerable communities.
- The micro-insurance product is a parametric policy called the Livelihood Protection Policy (LPP), which covers risks from high winds and heavy rainfall.
- Product development is complete and the insurance company is now securing approvals from insurance regulators (from each pilot country) to market the LPP in five pilot countries.



Challenges: Product development costs, regulatory environment, expertise and knowledge, market awareness and



Thank you!

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