DEG working paper

bond

Finance for Loss and Damage

Marrakech and beyond

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About Bond

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The Bond Development and Environment Group provides a forum where NGOs working at the interface of environment and poverty issues can exchange information, enhance their analysis and coordinate advocacy work.

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Introduction

This paper contains recommendations from Bond members on the subject of finance for Loss and Damage (L&D) associated with climate change impacts for governments to take up at COP22/CMA1[1] in Marrakech and beyond. While it is positive that the Paris Agreement states that Parties should enhance support for L&D, including through the Warsaw International Mechanism (WIM), efforts to date have been extremely slow in this area and more resources are needed. We welcome the WIM's 'framework' for a five-year workplan,[2] but note that it contains only a placeholder for finance-related activities. We expect the Marrakech Conference to give the clear message to the WIM that it should – with support from the Standing Committee on Finance (SCF) – focus on this area in 2017.

Context

L&D is already a real manifestation of climate injustice.

Climate change is already affecting poor people around the world, and for some climate change impacts have already crossed the line into loss and damage. Impacts such as Cyclone Pam that damaged or destroyed 80% of buildings on Vanuatu and put back development efforts[3]; increasingly erratic rainfall and extreme droughts that have resulted in food shortages across the Sahel region[4]; two years of extreme drought in the southern Africa region that have combined with El Niño to leave, for instance, 40% of the population of Malawi food insecure and in need of assistance[5]; and rising sea levels that are resulting in people in low lying areas, such as Bangladesh, already losing their land[6]. These people have suffered loss and damage from climate change. Overwhelmingly the people facing the worst impacts are poor, and have contributed almost nothing to the emissions causing climate change. The Paris Agreement recognised this injustice and established L&D as a standalone element (Article 8) acknowledging that the international community must provide support, including finance, for L&D. Rich and historically polluting countries, such as the UK and other developed countries, have a responsibility to live up to the commitments made in the Paris Agreement to ensure that the poorest and the most vulnerable are not left facing the devastating consequences of our pollution on their own.

1. L&D finance is additional and needs to be defined

L&D finance is separate from and must be additional to adaptation finance, and the CMA must agree a definition of L&D finance to operationalise this distinction.

- The Paris Agreement makes clear that L&D is separate from adaptation by addressing it in its own article (Article 8). Article 8.3 states that "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".
- Article 8.4 does, however, include some categories of adaptation and broader resilience building activities (such as early warning systems) in those areas it mentions relating to L&D. This highlights

the importance of reducing L&D through adaptation and risk reduction activities, but there is still a clear need for an internationally agreed definition of what should be counted as finance for L&D, which the Paris Agreement states that Parties should enhance, and which should be accounted for in the global stocktakes. This in turn might be helped by a definition of L&D.

- The Standing Committee on Finance (SCF)'s definition of "climate finance" (copied below) does not include L&D: there is therefore a specific need to develop a definition of L&D finance, and to request that the SCF account for it in future biennial assessments of climate finance – from 2018 onwards.

> "*Climate finance aims at reducing emissions, and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts*." (2014 Biennial Assessment and Overview of Climate Finance Flows, p.5)

Recommendations:

- COP22/CMA1 should ask the WIM and the SCF to jointly undertake work to develop a definition for L&D finance, which would then be used by Parties to report on L&D finance separately to adaptation finance, and by the SCF in their next biennial assessment of finance.
- This definition would help to avoid double counting and ensure that L&D finance does not undermine or duplicate adaptation finance.

2. The scale of L&D finance needs

L&D needs may reach the order of one trillion US dollars per year - the same order of magnitude or more than adaptation needs – further studies on L&D finance needs are required.

- Available studies on the global scale of L&D indicate that this figure rises to around $1 trillion per year: ActionAid (2010) cite Hope's 2009 study estimating a range of $0.3-2.8 trillion in 2060 after mitigation and adaptation, with an average of $1.2 trillion. Annual damage would continue to rise after this year, with a total damage of $275 trillion from 2000 to 2200 with likely adaptation and with stabilising emissions at 450ppm – this figure increases to $890 trillion with a business-as-usual emissions trajectory. More recently, Baarsch et al. (2015) suggest L&D costs (not needs) for developing countries of around $400bn in 2030, rising to $1-2 trillion by 2050. DARA (2012) estimate global climate change-induced L&D in 2010 at almost $700bn (with over 80% of net losses falling on developing countries), rising to $4 trillion by 2030 (with developing countries bearing over 90% of net losses). UNEP's *Africa's Adaptation Gap 2* report (2015) estimates L&D costs for Africa, assuming cost-optimised adaptation effort, at just over $100bn per year by 2050 (on top of adaptation costs of $50bn) if warming is kept below 2^{o}C, and around $160bn per year (on top of adaptation costs of $95bn) if warming goes above 4^{o}C.
- Further work is required on the methodologies and processes for estimating L&D and associated finance needs, as well as non-economic losses.

Recommendations:

- The Marrakech Conference should invite the Intergovernmental Panel on Climate Change (IPCC) to coordinate a scientific assessment to estimate the total economic and non-economic L&D and its associated finance needs for different mitigation, adaptation and global temperature scenarios. This should identify and apply suitable methodologies for estimating the percentage of projected damage from specific categories of disasters that can be attributed to climate change (*ex ante*). It should also evaluate methodologies for attributing specific events to climate change (*ex post*) and recommend how these could be used to inform disbursement of and accounting for L&D finance.
- The WIM should then use the IPCC findings to inform its work on finance (though it should not wait for this report to finalise and start work on its five-year workplan).

3. Finance targets and their interdependence

L&D must be reduced by enhanced mitigation and adaptation effort, and COP22/CMA1 should establish a process to determine separate finance targets for adaptation and L&D, which, from 2025, are dependent on the level of mitigation effort achieved

- The UNFCCC needs to establish new and additional L&D finance targets to reflect the commitment in the Paris Agreement for Parties to provide support for L&D, as L&D is not included in the SFC's definition of climate finance nor the $100bn per year target committed to mitigation and adaptation.
- Separate adaptation and L&D finance targets must be set in ways that are dependent on actual global warming outcomes (i.e. linked to mitigation effort).

Recommendations:

- COP22/CMA1 should establish a process to determine separate science-based finance targets for adaptation and L&D.
- Given that L&D is already a reality, COP22/CMA1 should send a clear message that additional funds must be set aside for L&D immediately, and agree to establish a target for L&D finance from 2020 on top of the $100bn per year. If time allows, this target should be informed by the above-mentioned IPCC assessment, taking into account the levels of adaptation support provided. Otherwise, existing studies should be used to derive an appropriate target for 2020.
- As part of the process for establishing an increased overall level of climate finance after 2025, adaptation and L&D finance targets from 2026 to 2030 should be set based on bottom-up scientific needs assessments, where possible, and linked to mitigation efforts, with a minimum 2030 adaptation finance target set at $140bn per year, as suggested by UNEP (2016). Further, the L&D finance targets should be informed by the above-mentioned IPCC assessment and dependent upon the required adaptation support being provided.

4. Mechanisms for L&D finance

COP22/CMA1 should ask WIM and the SCF to identify finance mechanisms for L&D: a WIM finance panel should be established and ensure sufficient L&D finance is equitably mobilised and appropriately allocated.

- Currently the climate finance mechanisms of the UNFCCC do not address L&D. There is therefore a need to determine which will be the finance mechanisms for L&D. Questions such as whether the GCF and the LDCF should have L&D windows and whether the WIM should establish its own L&D finance mechanism should be addressed.
- It should be noted that finance used to fund activities aimed at reducing L&D is not L&D finance: for example, finance for early warning systems and emergency preparedness would be disaster risk reduction finance or, to the extent that these activities are a response to projected impacts of climate change, adaptation finance, not L&D finance: this should be clarified through the definition mentioned above.

Recommendations:

- COP22/CMA1 should mandate the strengthening, including through the adequate resourcing, of the WIM as a forum for facilitating financing, technology cooperation, capacity development and knowledge exchange for addressing L&D.
- COP22/CMA1 should further request WIM to establish a finance panel whose primary role is to coordinate efforts to ensure that adequate finance for L&D is equitably raised, allocated to and disbursed by the most appropriate finance mechanisms under the Convention, in association with the development and application of appropriate policy and legal frameworks. The panel’s first task should be to identify, in collaboration with the SCF, the financial mechanism of the Paris Agreement and other appropriate funds and mechanisms, for both slow- and rapid-onset events, including the proposal of any new mechanisms deemed necessary.

5. Expanding the focus from insurance

L&D finance requires a comprehensive approach, with a range of financial mechanisms, instruments and policy and legal frameworks, which must be rights-based and gender equitable – there is currently too much focus on insurance in the L&D finance discussion.

- The right forms of insurance can be an element of a comprehensive L&D finance approach, but there is currently too much focus on insurance. Insurance cannot cover all L&D, and in many circumstances more cost-effective and equitable solutions, such as enhanced social protection, exist for L&D and for the broader objective of comprehensive risk management. In particular, the poorest and most vulnerable may be uninsurable to certain climate risks, such as sea-level rise and other slow onset events.

- The desirable aspects of a well-functioning insurance scheme – timely provision of finance in response to pre-determined trigger conditions having been met – are not unique to a premiums-based insurance model and can be used with contingency funds, for example. Further analysis and discussion of the potential role for catastrophe bonds, and their suitability for the poorest and most vulnerable countries, is also required.
- The recent El Niño-induced droughts and flooding have demonstrated the need for more joined-up discussion and planning among humanitarian, development and climate sectors, including their finance mechanisms, and alignment of social protection, climate change and disaster risk reduction policies.
- The design, implementation and monitoring of a comprehensive L&D finance system must be participatory, bottom-up, rights-based, gender-equitable and subject to adequate environmental and social safeguards.

6. The appropriate role for the right kind of insurance

All climate risk insurance should be openly and transparently assessed as appropriate, equitable, effective and pro-poor. There should be no assumption that poor people can, or should, pay premiums for climate risk insurance.

- Insurance and financial risk transfer mechanisms, if applied appropriately, **can be a useful component** of L&D finance. By providing timely payments to prevent economic losses insurance can prevent people falling into poverty; it can provide greater security for investments and access to credit; and it can encourage a planned, contractual rather than ad hoc way of dealing with risk.
- However, **insurance should not be over emphasized**, as it is only relevant for some climate impacts and others, such as highly probable, slow-onset events or very frequent events, may not be insurable. A comprehensive climate risk framework including mitigation, adaptation, and disaster risk reduction (DRR), social protection schemes, and equitable access to resources and public services are all essential and should not be overlooked or under-funded in favour of insurance.
- Insurance should be driven by the demands and needs of climate change-affected **communities**, including by their participating in the design of schemes, in contingency planning and in the tracking and accountability of payouts. Gender equity should be ensured, and adverse impacts on the poorest, including landless, who may not be able to access insurance schemes or their eventual payouts, must be avoided.
- Where climate risk insurance is appropriate, climate justice and equity dictate that there must be **sustained, predictable and long-term financial support to pay the premiums** for vulnerable countries (macro-level insurance), individuals (micro-level) and associations (meso-level). In most rich countries, agriculture and flood insurance is heavily subsidised by the government (Bond, 2016).
- Climate risk insurance should not be a mechanism for private companies to **profit** from the risk faced by the poor and vulnerable, nor should it be a mechanism to **transfer responsibility** from historically polluting countries to the poor.

- Climate risk insurance schemes should reduce, never increase, **financial risk** to the poor. Basis risk funds[7] and other back-ups are necessary to ensure that where the insurance model fails the poorest are not left bearing the brunt.
- At present **development partners are focusing too much on one insurance model – sovereign risk pooling** – whereas different models are appropriate for different contexts. For example, more should be done to promote the delivery of insurance at scale through member-owned institutions of the poor such as cooperatives and self-help groups, and to strengthen these institutions. A risk-layering approach is also important: micro-insurance for individuals may be better suited to more localised and lower-threshold climate shocks, which do not trigger at the relatively high threshold of macro-level models. **All levels of insurance must be made affordable and accessible through appropriate premium support.** An equitable and cost-effective solution to the current piecemeal financing arrangements would be a **global social protection and crisis fund**, which would support developing countries to put in place universal social protection minimums and scale these up in times of crisis through a **not-for-profit reinsurance arm** (based on the proposal by De Schutter & Sepúlveda in *Underwriting the Poor*, 2012).
- Insurance should be treated as a mechanism for addressing L&D and its financing treated as L&D finance, as pay-outs address L&D. Aspects to promote adaptation (e.g. incentives for risk reduction) must be tested for additionality (i.e. would they have happened anyway) and robustness (i.e. will they actually have the claimed adaptation effect) and only the relevant portion of the cost attributed to adaptation.
- Insurers should use their $30 trillion in assets to become a global force for divestment and sustainable investment. Currently, just 1% of insurers are assessing the risk of stranded assets in their investments and only 5% are measuring portfolio carbon emissions (Bond, 2016).

Recommendations:

- Governments should not allow (nor subsidise) private insurance companies to engage in climate risk insurance until they have divested from fossil fuels.
- The WIM Clearing House on Risk Transfer, the G7 InsuResilience initiative, the Insurance Development Forum and other bodies dealing with climate risk insurance schemes, should adopt pro-poor principles (sketched out above, and available in more detail in Bond DEG's companion paper on insurance), and should report against these principles in a fully transparent manner.

7. Sources of L&D finance

Innovative but equitable sources of finance are required to meet the scale of adaptation and L&D finance needs, and suitable options exist – governments must commit to their utilisation at COP22/CMA1 and put in place the necessary policies and laws

- There is a huge gap in finance for both adaptation and L&D of the order of hundreds of billions of dollars a year, likely to rise to the order of trillions, much of which needs to be provided in the form of public grants from rich nations. Hence rich nations must respond by identifying sources of finance of this order and putting in place the policies and legal frameworks required to generate them at the level required.

- A solution that implicitly says that the only way to finance L&D is to open up profit-making opportunities for the private insurance market is not acceptable – the insurance component of an international L&D finance system must be not-for-profit.
- Furthermore, while climate and catastrophe bonds may hold potential for raising funds for certain investments, there are doubts over whether the poorest of countries will be able to attract such investments, and even more so for L&D (WIM, 2016).
- However, there are indeed innovative, equitable, adequate and additional sources of financing that could be made available for L&D with sufficient political will. These include (see Durand et al., 2016):
    - financial transaction tax
    - international airline passenger levy
    - bunker fuels levy
    - (progressive and equitable) carbon taxes
    - fossil fuel majors levy
    - reallocation of fossil fuel subsidies and military budgets
- Such efforts to raise funds for L&D finance must also be supported by sustainable investment from sovereign and private investors, including insurance and pensions companies.
- Developing countries and development partners should also build up contingency funds for use as soon as early warning systems signal impending crises. But the capacity of developing countries to put aside such funds is very limited. This highlights the importance of debt cancellation, or debt swaps for climate change action where appropriate, as some SIDS are now doing or requesting.[8] It also underlines the need for developed countries to enable developing countries to enhance their domestic resource mobilisation, including through the former ensuring that their companies pay fair tax levels when operating in the latter. Development partners should furthermore provide contingency funds in the form of grants not credit.

Recommendations:

- At COP22, governments should mandate the WIM to develop a strong finance stream within its workplan, including a plan to explore the innovative sources of finance mentioned above, with options for how each could be implemented and the potential for raising finance from each. These options should be brought forward for a decision leading to implementation at COP23 or 24. This work should take place within the context of the massive gap in L&D finance, recognizing that developing countries urgently need financial help to deal with L&D from climate impacts.

[1] The first session of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA 1) will take place in Bab Ighli, Marrakech, Morocco in conjunction with COP22 and CMP12.

[2] As set out in the WIM Executive Committee's report to COP22 http://unfccc.int/resource/docs/2016/sb/eng/03.pdf

[3] Al Jazeera, 16 March 2015 http://www.aljazeera.com/news/2015/03/vanuatu-development-wiped-monster-cyclone-pam-150316032518300.html

[4] UNCCD 2014. Desertification: The Invisible Front Line http://www.unccd.int/Lists/SiteDocumentLibrary/Publications/NEW_Invisible_%20Front_Line_%20EN.pdf

[5] CARE 2016. Factsheet: El Nino Drought Crisis in Southern Africa. August 2016 http://www.care-international.org/files/files/18082018SouthernAfricaRegionalFactsheet.pdf

[6] Mortreux, C. and Adams, H. 2015. Setting the scene: national and deltaic migration trends in India, Bangladesh and Ghana. Deltas, Vulnerability and Climate Change: Migration and Adaptation (DECCMA)

[7] Basis risk is the difference between the pay-out triggered (or not) by a peril in a parametric or index-based insurance scheme and the actual damage experienced by the insured. A basis risk fund is a back-up mechanism to ensure that damage is (at least partially) paid for even when the parameter or index used in the scheme does not reach the pre-determined threshold for a pay-out. Basis risk often occurs due to inadequate data or monitoring systems or poorly designed indices.

[8] See for example the Commonwealth proposal (http://www.oecd-ilibrary.org/commonwealth/development/debt-swaps-for-climate-change-adaptation-and-mitigation_5js4t74262f7-en), the ECLAC Caribbean Resilience Fund proposal (http://www.cepal.org/en/pressreleases/eclac-presents-debt-alleviation-strategy-based-debt-swap-proposal-high-level-meeting) and the Seychelles debt swap (http://www.naturevesttnc.org/pdf/Project-Profile-Seychelles.pdf)

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