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The case for developing inclusive risk financing solutions to promote human security and resilience in the Maldives

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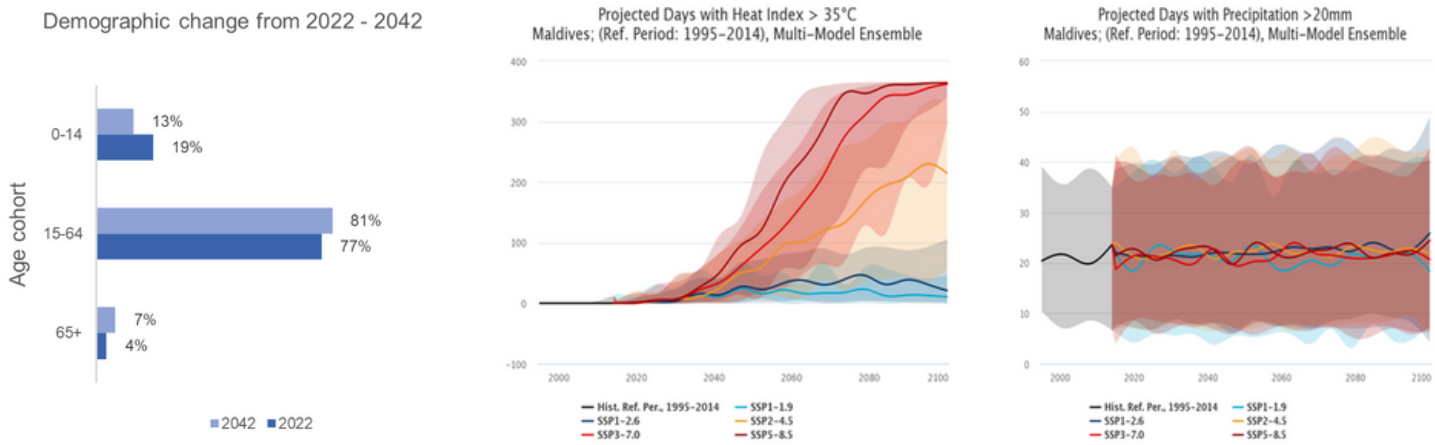
Anthropocene effects, which emerge from human activities dominating life on the planet, are developing cross-scale systemic environmental risks and increasing human insecurities around the world, according to UNDP's Human Development Report (HDR) for 2021/2022. The report finds that countries Human Development Index scores have declined in over 90% of the countries between 2020/2021, largely driven by dangerous planetary changes, and sweeping social and economic shifts due to the compounding crises of climate change, pollution and biodiversity loss, ongoing conflicts, and the COVID19 pandemic. Navigating these layers of interacting risks will require improved strategies for human security.

For the first time since publication began 32 years ago, the HDR calls for the use of insurance as one of the strategic tools to tackle the multi-faceted nature of uncertainties faced by humanity. The report also advocates for an expansion of insurance markets and the development of innovative insurance solutions to cross-scale systemic risks, for which existing actuarial practices may not be fully adequate.

Insurance, as a risk financing instrument, offers protection and compensation against shocks emanating from the interacting layers of uncertainty. The Maldives faces its own set of social and environmental challenges, for which risk-transfer

Figure 1: The slow-onset, twin vulnerabilities from demographic and climate change facing the Maldives



Source: Demographic projections taken from the Maldives Bureau of Statistics (MBS); Maldives Population Forecast 2014-2054; Weather forecast for heat index and precipitation, taken from the climate knowledge portal of the World Bank, for the Maldives

solutions integrated into a portfolio of risk financing instruments co-developed with the private sector should complement existing public finance solutions. Available data (Figure 1) suggests that in the Maldives, the number of elderly persons will nearly double in the next two decades, while also facing significant climate risks including the rise of temperature and the possibility of increased droughts in the long term. Both issues are worrisome changes the country faces, which will require a robust response that go beyond existing public financing capabilities while ensuring long-term fiscal sustainability.

The Maldives has looked at risk financing as a public finance issue: the cost of state-funded social insurance programs represent 18% of the national budget in 2022, while the financial impact of a range of large scale man-made and natural disasters (such as catastrophic fires, flooding, shortage of water, heavy rain) continues to be borne by the state. Budgetary data show that the Government has consistently over-spent its annual budgetary allocations on disaster risk assistance, 5 out of 7 times between 2014-2020 - spending a total of $12.4 million during this period for relief efforts. The prevailing risk financing model of risk retention (reliance on budget reserves, reallocation, contingent credit lines) driven by public finance may become unsustainable as climate change worsens, and as the country looks towards a much older population in the next decade. The costs of uncertainty require a better understanding of risk profiles of stakeholders and an appropriate mix of risk financing solutions to be used that will allow government either to retain or to transfer risks to market. Smarter approaches to risk financing, such as insurance, will be required to tackle this issue.

In an upcoming risk finance diagnostic study conducted by UNDP in partnership with the Maldives Monetary Authority (MMA) puts in evidence the state of play in the Maldives insurance market, and the extent to which the insurance sector can be further developed to provide coverage against potential financial losses in several major industries. The study has revealed that insurance coverage for overall disaster losses remains low at 5% and has identified several foundational gaps that the country should address to create a viable insurance options. The study has further found that existing national frameworks for Disaster Risk Management (e.g National DRM law) does not recognise the role of a financial mechanism such as insurance for disaster risk financing, and national authorities have weak data management capacities for profiling hazards, typically required for pricing insurance products.

Existing insurance products are considered to be inadequate to provide coverage for large scale and high-impact disasters in big industries such as tourism and construction, despite the country having 44% of all settlement footprints on all islands and more than 70% of all critical infrastructures within 100 meters of the shoreline. For industries such as fisheries and agriculture, there is a total lack of dedicated insurance products that will provide coverage for crop losses and habitat degradation from natural and man-made disasters. The Maldives is home to the 7th largest coral reef system on Earth, representing 3.14% of the global reef system. The systemic loss of this rich biodiversity can have severe economic repercussions through losses of revenue and livelihoods from key industries such as tourism and fisheries. Despite this apparent risk, there is yet no national mechanism to insure nature as a strategic asset base and the Maldives remains excessively exposed to natural and man-made disasters.

Despite lacking the ideal conditions for an insurance market development, the insurance sector has been giving signals of growth in the Maldives and this momentum can be further championed. The uptake of

insurance based on Gross Written Premiums (GWP)[1] has increased steadily every year, from $49.87 million in 2017 to $74.86 million in 2021. Both life and non-life insurance segments have experienced positive trends. A few strategic initiatives can be further sustained and deliver results grounded with inclusive principles.

- First, the government can drive the development of capacity for key stakeholders of the insurance ecosystem and leverage existing tools and regional and global partnerships that can provide technical support for regulators, supervisors and insurers. Developing human capital for the insurance sector should also be a long-term goal through the establishment of formal training and certification programs, since many staff of insurance companies have only learned about insurance through informal and non-systematic channels, which is a key insight gathered through the insurance diagnostic report.

- Second, the government can encourage the creation and piloting of pro-poor and innovative insurance products that address the risk protection needs of key unserved sectors, such as agriculture and fisheries, for which currently solutions are either lacking or altogether absent. As there is no notable insurance for either agriculture or fisheries, the government could consider establishing a scheme covering multiple perils for a range of assets ranging from crops, livestock and aquaculture. Due to scale issues in Maldives, market-based products may not be viable for these largely untested sectors and therefore, risk pooling among insurers would be a more effective way to generate scale and lower insurance premiums in the long run. To assist with the development of a national scheme, the government may consider utilising existing budgetary allocations for disaster risk management for "smart-subsidies" to foster market growth. Subsidies could be gradually phased out once the market matures and the private sector effectively becomes an intrinsic provider of risk financing in times of disasters. It will also help the government cap its budgetary allocations and minimise the financial impact from high-risk incidents. Government assistance at the nascent stage of agricultural and fisheries insurance will also ensure affordability of such insurance products, and this is especially important given the high dependence of vulnerable cohorts on these industries for livelihoods. A pro-poor approach can ensure greater uptake of insurance solutions and create awareness on insurance products, the lack of which is highlighted by industry experts as a major bottleneck for mainstreaming insurance in Maldives.

- Third, the Maldives can also explore the development of a national insurance mechanism for the protection of public and natural assets including high-value and critical infrastructure and coral reefs. With the participation of local insurers and potential support of global reinsurers, the risk pooling mechanism will aim to spread the risk. A single insurance provider will not have the capacity to insure these assets and a government-led scheme which brings together all insurance players can increase the collective capacity to absorb risks. Exploring the feasibility of such a scheme will require government to take steps towards designating strategic natural assets (such as coral reef systems) and critical infrastructure as public assets and to consider making insurance coverage for such assets mandatory. Consequently, a national register of public assets, including information on financial values will have

[1] MMA monthly statistics, July 2022

to be established. Such information will help insurance providers determine risk exposure, insurance premiums and insurability of the assets. Under such a scheme insurance premiums and claims can be shared between all participating insurers. The government can also take steps to internalise certain insurance markets (e.g. travel insurance for tourists), which will have the effect of positioning the insurance industry as a net receiver of foreign income in the long run as insurance premiums will be received by local insurance providers.

- Finally, the development of regulations and policymaking for insurance will serve as the backbone of previous recommendations on insurance market development. The leadership of Maldives financial regulators will be crucial for this and the development of a 3-5 years roadmap that encapsulates the components for strengthening insurance capacity at all levels would be a strategic approach to align with the forthcoming approval of the Insurance Law.

The implications for the Maldives of failing to integrate risk transfer solutions into broader risk management and financial inclusion strategies and to encourage greater private sector collaboration can leave a high level of concentrated risks in the government accounts. Risk transfer mechanisms which are developed and delivered by public and private sector, and which respond to diverse risk profiles and protection needs are an important part of global adaptation financing plans. The failure to create such mechanisms can be costly overall. In a study published in July 2022[2], researchers from the University of London, demonstrated that sovereign debt sustainability can deteriorate significantly in a partial collapse of ecosystem services from a sample of six countries – Bangladesh, Brazil, Canada, Indone-sia, Nigeria and Vietnam. In the case of Bangladesh, a partial nature collapse would lead to a 15% point increase in debt-to-GDP, which is 3-4 times more damaging to Bangladesh's debt sustainability than the COVID-19 pandemic has been. There has been a growing call for factoring in climate risks and biodiversity losses in debt vulnerability assessments such as the IMF's Debt Sustainability Analysis, which shapes the fund's economic programmes in many countries. The failure to account for, mitigate and adapt to these losses is now seen as source of risk relevant for financial stability in many countries. Major credit rating agencies are already in the process of integrating climate risks into existing country rating methodologies, and cost of borrowing is likely to increase without a robust plan for adaptation, including financing options.

Insurance solutions alone will not mitigate the risk of credit downgrades, but it is an important starting point for the most climate vulnerable countries in the world such as the Maldives to build fiscal buffers and to share the risks more evenly across public and private sector. There is great concern that integrating climate risks in existing debt sustainability analysis can negatively affect the most climate vulnerable countries, as such countries find themselves facing credit downgrades - raising their cost of borrowing and restricting their access to international financial markets. However, international action on creating a more equitable basis for just climate transition, and on this important issue has been limited, leaving the most climate vulnerable countries largely on their own to deal with the consequences. Creating robust adaptation plans and improving internal and external risk transfer solutions, is a low-hanging fruit and that countries can pursue on its own. UNDP work[3] on global debt vulnerabilities show that 54 developing economies face severe debt problems. This is more than 3 percent of the global economy, and 18 percent

[2] University of London (2022): Nature Loss and Sovereign Credit Ratings.
[3] UNDP (2022): Avoiding 'Too Little Too Late' on international Debt Relief

of the world's population, and includes 28 of the world's top-50 most climate vulnerable countries. A risk mainstreaming approach, designed to create a more evenly balanced risk transfer solution between public and private sector could also be a quicker and more cost-effective solution that climate vulnerable countries can take, in parallel to the implementation of mitigation and adaptation infrastructure development.

UNDP's flagship Insurance Risk Finance Facility (IRFF) has taken important steps through the identification of suitable pathways by conducting the diagnostic study on insurance sector development in Maldives. The IRFF workstreams cover inclusive insurance, sovereign risk financing, insurance investments, natural capital, and insurance in development frameworks, and UNDP is working globally with financial services regulators and insurers to enhance industry legislation, regulation, and institutional capacity. The recommendations of the diagnostic report, highlighted in this bulletin, are expected to provide a comprehensive stocktake of gaps in the insurance market, and identify future areas of broader support on market development. Insurance market development in the Maldives would be a multistakeholder effort, given that ideally all major industries would require the integration of risk-transfer solutions as a way of conducting business, and capacities of government entities, insurers and other stakeholders would need to be built, alongside creating awareness on insurance solutions. UNDP stands ready to support the Government in strengthening the enabling conditions and developing inclusive insurance solutions in support of achieving Agenda 2030 in the Maldives.

"With the quarterly Economic Bulletin, UNDP in Maldives intends to revamp its support to SDG Integration to ensure faster progress on sustainable development and offer narrative options in areas such as integrated policy and programming solutions; SDG metrics; and data and analysis using tools for modelling and forecasting.

We aim at promoting the sharing of knowledge as well as innovation, and solicit a more robust pace towards SDG Financing so to expand public and private contributions to reach the 2030 Agenda."

– Enrico Gaveglia, UNDP Resident Representative in the Maldives.

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