



# African Risk Capacity: An African-led Strategy for Managing Extreme Weather Risks

Second Forum of the Standing Committee on Finance, UNFCCC  
Montego Bay, 21-22 June 2014



## African Risk Capacity (ARC)



**The African Risk Capacity is a continental sovereign risk pool and early response mechanism designed to provide cost-effective contingency funding to African governments to execute pre-approved contingency plans in the event of severe weather disasters**

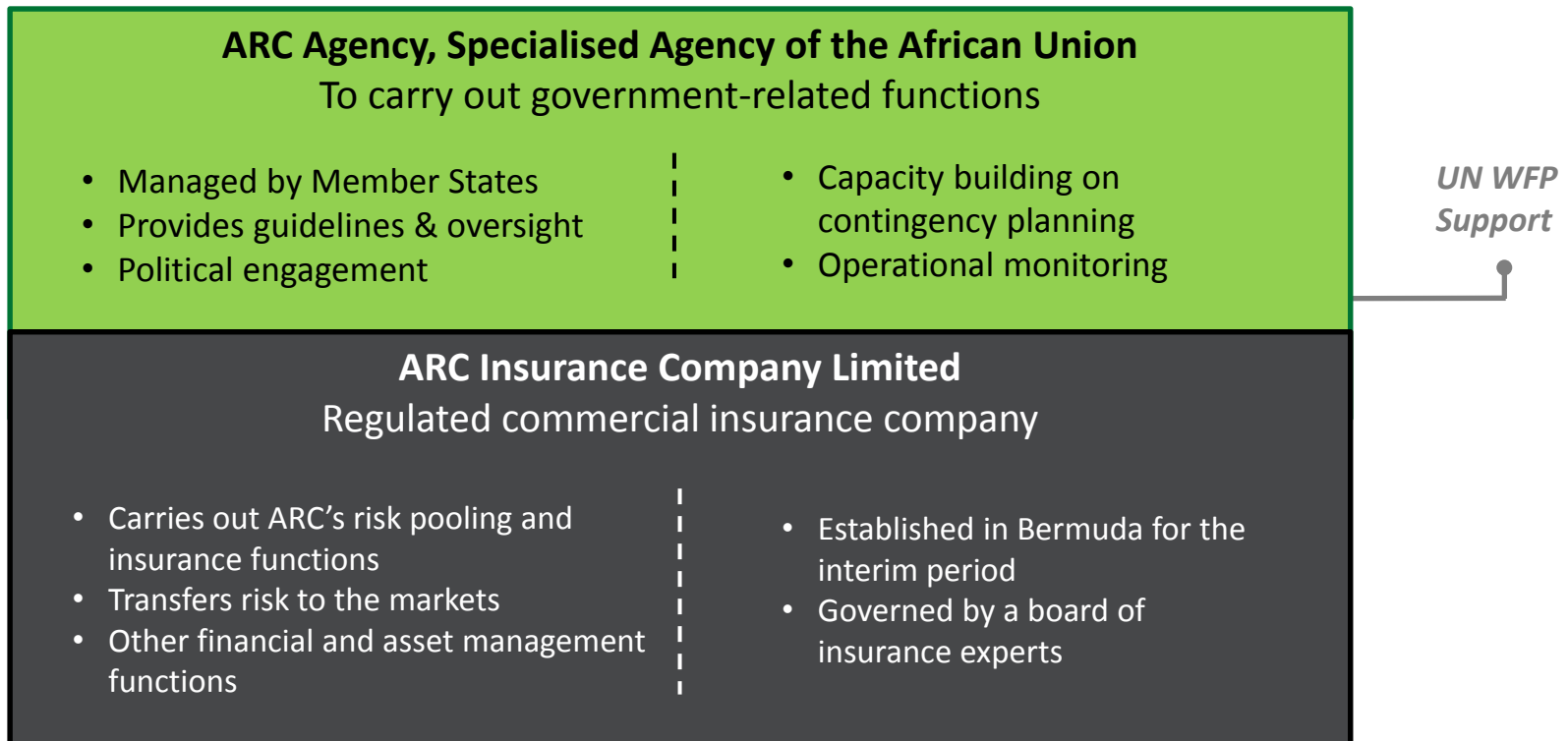
**ARC's mission is to help African Union Member States improve their capacities to better plan, prepare and respond to extreme weather events and natural disasters and to assist its Member States to protect the food security of their vulnerable populations**

**Jointly developed by the African Union Commission and UN World Food Programme**

# ARC Structure

## Unique two-entity structure:

- ARC Agency, a Specialised Agency of the African Union created by treaty
- ARC Insurance Company Limited, a hybrid-mutual insurance company domiciled in Bermuda



## Three ARC Pillars Creating Value

A small graphic of a globe showing the African continent, positioned on the right side of the green header bar.

**ARC bring together three critical elements to achieve its mission:**

- **Early Warning:** *Africa RiskView*
- **Insurance:** Index-based insurance and risk pooling
- **Response:** Contingency Planning

**Two value drivers make ARC an efficient tool to manage droughts and other risks for Member States:**

- **Improved risk management** through risk transfer and risk pooling
  - **Early response actions** and improved targeting
- **Estimated cost benefit** of US\$ 4.4 for every US\$ 1 spent on ARC versus traditional emergency response<sup>1</sup>

<sup>1</sup> ARC Cost Benefit Analysis, IFPRI, Oxford University and Boston Consulting Group

## ARC Agency



### **ARC Agency provides and enforces standards for its Member countries:**

- Established by treaty, negotiated by 41 Member States in November 2012
- Accountable to Conference of the Parties, composed of 24 signatories
- Managed by Governing Board, chaired by Dr Ngozi Okonjo-Iweala, Coordinating Minister for the Economy and Honourable Minister of Finance of Nigeria

## ARC Agency



**ARC Agency is the gateway for countries to become policyholders of ARC Ltd**

- One year+ pre-participation training and capacity building programme

**Certificate of Good Standing (CGS) issued by ARC Agency is a prerequisite for buying insurance from ARC Ltd**

**For a CGS countries must complete the pre-participation programme:**

- Customise *Africa RiskView* and select insurance parameters
- Have a contingency plan for the use of a potential insurance payout approved by the ARC Agency's Board ("Peer Review")



***ARC Agency Governing Board***

**ARC Agency sets planning and response standards and monitors payout implementations**



## ARC Ltd

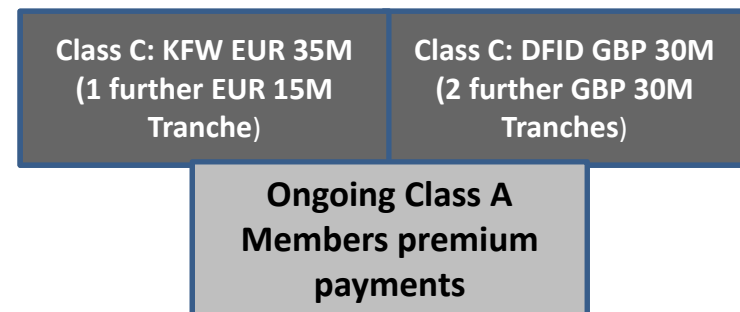


**As a hybrid-mutual insurance company, ARC Ltd is owned by its members and issues *Africa RiskView*-based parametric weather insurance policies:**

- **Policyholder Countries:** Agency Member States with current Certificates of Good Standing and active insurance policies
  - **In 2014: Kenya, Mauritania, Mozambique, Niger and Senegal**
- **Capital Providers:** Entities that give funds to ARC Ltd
  - Initial capital provided by **United Kingdom (DFID) and Germany (KfW)**, to be returned without interest by 2034

**Operates independently of the Agency as a separate legal and financial entity**

- Capitalised and registered as a Class 2 insurer by Bermuda Monetary Authority in March 2014
- Day-to-day operations outsourced and overseen by Board chaired by Dr Lars Thunell, former IFC CEO:



*ARC Ltd Capital Structure*

- Insurance Manager: **Marsh** • Auditor: **PWC** • Re-Broker: **Willis** • Underwriter & CEO: **Dr Simon Young**

## ARC in Action: 2014



**In 2013-14 ARC Agency worked with six countries towards participation in the first insurance pool**

**Inaugural pool launched 1st May 2014 with five countries insured for US\$ 135 million against drought for a premium of US\$ 17.5 million**

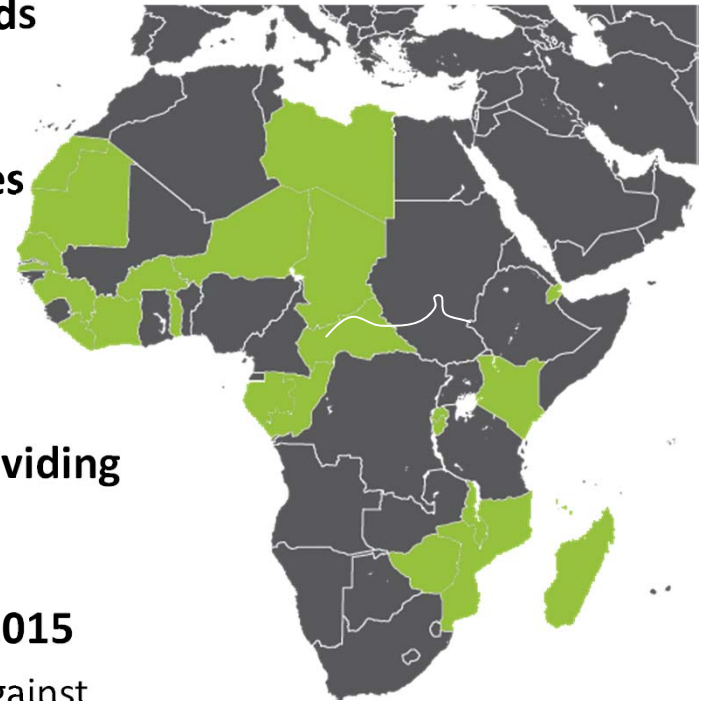
- Kenya, Mauritania, Mozambique, Niger, Senegal

**Aggregate XL reinsurance structure placed in market providing US\$ 55 million in coverage for 2014 policy period**

**ARC Agency starting to work with 8 more countries for 2015**

- Aims to reach 20 countries by 2019 by providing coverage against drought and flood

- ✓ **ARC serves as an operational and concrete example of countries taking innovative steps to reduce climate risk and to access private capital**



**24 ARC Signatories**



## Private Sector Engagement

A small graphic of a globe showing the African continent, positioned on the right side of the green header bar.

### **Private sector role in ARC is to provide reinsurance capacity**

- Very high interest from market seeking new, uncorrelated risk
- ARC aggregates risk and keeps transaction costs to a minimum to attract risk capacity providers
- 12 reinsurers part of the 2014 reinsurance panel
- Significant future capacity available

### **Significant investment was required through 5 year design and establishment process to create this “enabling” environment:**

- At the institutional level, creating an African-owned framework to:
  - ✓ *Generate political will and demand*
  - ✓ *Invest in long-term capacity building*
  - ✓ *Create and define linkages to African’s development and resilience-building agenda*
- At the technical level:
  - ✓ *Building Africa RiskView to market-acceptable levels while addressing the specific food security needs of ARC Member States*
  - ✓ *Designing and capitalising ARC Ltd*

## Private Sector Engagement



**Barriers to private sector engagement beyond reinsurance provision are high: designing and establishing ARC could only happen with *in-house* expertise and donor support**

- Lengthy, time-consuming and expensive work not aligned with private sector incentives
  - Specialized and complex work requiring multiple disciplines not usually found in the private sector:
    - Food security modelling and early warning systems in Africa
    - Emergency response: humanitarian, social safety nets
    - AU Member State and donor political engagement
  - ARC design team included experts from risk financing, AU, humanitarian and development backgrounds
- ✓ **In the long term ARC's design will allow for ARC Ltd to stand on its own as a commercial operation, once ARC Agency's capacity building services are no longer required**

## Future ARC Group Initiatives



### **ARC plans to build on current private sector interest and Member State demand for climate risk management:**

- **ARC Extreme Climate Facility (XCF):** *XCF will be a data-driven financial facility, supported by both private and public funds, that tracks extreme climate shocks and pays out to countries to undertake adaptation if event frequency and intensity increases. ARC Agency was mandated to develop the XCF concept by the African Ministers of Finance on 30 March 2014*
  - **Sovereign Disaster Finance Ratings (SDFR):** *Developing a methodology to rate a country's ability to attract and channel international disaster financing to assist its population through functioning disaster management systems, effective financial mechanisms and consistent implementation. To be applied independently to facilitate private sector entry and public accountability*
- **Public-private enterprises are clearly a big part of the future in climate adaptation finance, but come at a price in terms of complexity**