

## **Submission by the United States to the Warsaw International Mechanism Executive Committee on financial instruments that address the risk of loss and damage**

The United States is pleased to respond to the call for submissions by the UNFCCC Executive Committee of the Warsaw International Mechanism for Loss and Damage on “best practices, challenges and lessons learned from existing financial instruments at all levels that address the risk of loss and damage.” The U.S. has significant experience with certain financial tools and finance-related approaches for addressing loss and damage, based both on our international development work and our domestic experience. We appreciate this opportunity to share some of our good practices, challenges and lessons learned by describing some of the tools and approaches we employ.

### **Tools and Approaches for Supporting Vulnerable Developing Countries**

Climate change poses new risks and challenges that require innovative and comprehensive approaches. The United States is committed to supporting vulnerable developing countries in their efforts to address loss and damage through a range of strategies, including adaptation and disaster risk reduction, risk transfer, climate resilient development, and humanitarian assistance. Announcements by President Obama and Secretary of State Kerry to support insurance coverage in vulnerable developing countries, to ensure that our international development programs and investments systematically take climate risk into account, and to double our adaptation finance by 2020 are just a few examples of this commitment.

For the purposes of this submission, we offer short descriptions of select efforts related to micro- and macro-insurance, as well as approaches to strengthening the resilience of communities and countries to climate and other shocks, including through joint humanitarian and development analysis, planning and implementation.

### **Financial tools as part of comprehensive approaches to risk management**

USAID has supported since 2012 the R4 Rural Resilience Initiative, led by the World Food Programme and Oxfam America. R4 takes a comprehensive approach to risk management by integrating insurance with risk reduction and financial tools like credit and savings. This combined approach enables farmers to take positive risks, such as investing in seeds and fertilizer, in order to improve food security and generate income, while also knowing that, if faced with a drought or other shock, they will have access to an insurance payout to help them purchase essentials without being forced to sell long-term, productive assets such as livestock. R4 has broken new ground in the field of rural risk management by enabling the poorest farmers to pay for crop insurance with their own labor through existing social safety nets and similar schemes.

### **Index insurance**

An important aspect of R4 is its use of index-based insurance. With conventional agricultural insurance, payouts to farmers after a poor growing season or extreme weather event are typically based on crop or animal loss, which requires verification through on-the-ground inspection. Costs associated with such verification are high, which, in turn, generally means that insurance premiums must also be high in order to cover costs. Thus, conventional insurance is often

unaffordable for most smallholder farmers. Without insurance, farmers may lack a safety net and often find it hard to convince banks to give them loans to invest in better inputs. With index insurance, payouts are triggered not by manually accounting for observed damages such as failed crops, but rather when an index—such as wind speed or an amount of rainfall over a specified time period—falls above or below a predetermined threshold. Because payouts do not depend on demonstrating losses, administrative costs are reduced, allowing insurers to price premiums at more affordable rates.

### **Local insurance market development, public-private partnerships**

The USAID-supported Agricultural Insurance Development Program (AIDP) aims to increase the resilience of agricultural producers against weather-related shocks by developing sustainable and cost-effective public private partnerships for insurance market development. As part of the World Bank's Disaster Risk Finance and Insurance Program, AIDP supports governments to utilize individual-level insurance instruments as part of their resilience and agricultural development strategies. The provision of catastrophic coverage for vulnerable populations through the private sector can further incentivize commercial insurance market development.

Key elements of support by AIDP include:

- technically sound agricultural risk assessment;
- strengthening of public-sector institutions to enable the use of financial risk transfer instruments to achieve social and development objectives;
- development of the data infrastructure necessary for insurance market development;
- building of public sector capacity to understand, oversee and promote insurance market development;
- dialogue between the public and private sector to enable governments to leverage the strengths of the private sector; and
- development and implementation of a comprehensive monitoring and evaluation framework to ensure the quality of protection provided to low-income families.

Kenya is an excellent example of how governments can use these instruments to advance their agricultural development and resilience agendas. With AIDP support, the Government of Kenya is aiming to establish a national agricultural insurance program with cover for both livestock and crops (i.e., maize and wheat). The first component, the Kenya Livestock Insurance Program (KLIP), will provide an innovative NDVI-indexed<sup>1</sup> insurance product to vulnerable pastoralists in the arid and semi-arid lands. The program was rolled out to 5,000 households in October 2015. Four additional counties are expected to be added to the program in October 2016.

By subsidizing catastrophic coverage for vulnerable households that are at risk of falling into destitution with the next shock, the government cost-effectively manages its own contingent liability while helping households protect their productive assets. Moreover, by using these market instruments to protect vulnerable households, the government creates enough market

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<sup>1</sup> NDVI is a satellite indicator of the availability of pasture forage that closely correlates with livestock mortality, at higher levels of mortality.

volume to incentivize the private sector to also offer insurance products to households further up the income strata. This program illustrates the complementary nature of public and commercial risk finance layers. The crop insurance program, the Kenyan Agricultural Insurance and Risk Management Program (KAIRMP), will initially focus on an area yield insurance product for semi-commercial maize and wheat farmers. Initial rollout will take place in spring 2016 in two counties and expand from there.

### **Coverage at the macro level**

While insuring the individual offers an important, direct way to allow households to avoid drops in consumption and protect assets in the face of shocks, there is also often a need for national governments to access quick liquidity to facilitate recovery and protect vulnerable populations. It is for this reason that the U.S. government also supports sovereign-level insurance coverage. One example of this is USAID's support for the African Risk Capacity (ARC), an African-owned, index-based sovereign risk insurance pool and early response mechanism that brings together the concepts of insurance and contingency planning. ARC is comprised of two components—ARC Agency, a Specialized Agency of the African Union, and ARC Insurance Company, Limited, a regulated mutual insurance company that is owned by member countries. Currently, ARC offers coverage for drought risk, but aims to expand its offerings to tropical cyclone and flood in 2016 and 2017, respectively.

Four countries participated in the first insurance pool during the 2014-2015 season: Kenya, Mauritania, Niger and Senegal. Niger, Senegal and Mauritania received payouts totaling \$26 million due to late and light rains. As a result of the 2014-2015 payouts, over 1.3 million people received assistance, and sales of subsidized animal feed benefitted over half a million livestock. During the 2015-2016 season, the risk pool expanded to include seven countries. ARC aims to reach 30 countries by 2020, providing nearly \$2 billion of coverage against drought, flood and cyclones, indirectly insuring 150 million Africans. The more rapid disbursement of ARC payouts (relative to the mobilization of humanitarian assistance) in the aftermath of a shock can be instrumental in avoiding negative coping strategies and loss of productive assets.

### **Capacity building and contingency planning combined with insurance**

In terms of lessons, ARC teaches us the value of combining contingency planning with risk transfer. Through ARC, Member States receive support to develop contingency plans and to improve their capacities related to planning, preparing and responding to extreme weather events and natural disasters. While payouts are made from the insurance company to the government, governments then use funds to implement their contingency plans, building on and reinforcing existing national institutional mechanisms and capacities.

### **Country-ownership with early donor engagement**

Country-ownership of financial tools like ARC is crucial for ensuring that country-identified needs are front and center in developing and implementing any tools. In addition to the value of country-ownership, ARC teaches us the importance of donor engagement, especially in the early stages. The establishment of the data platform that is the source of early warning information and used to determine if a trigger for payouts occurred was funded by donors, as is capacity building for contingency planning. While the products that ARC, Limited offers are largely paid for by

participating governments and are priced to provide for long-term sustainability of the facility, the initial capitalization for ARC, Limited came from donors in the form of interest-free loans.

In terms of challenges, we understand that, while ARC, Limited is fully capitalized, there remains need for funding of ARC Agency to support the institutional capacity building of participating governments to evaluate their risk exposure and determine coverage needs, as well as to develop effective contingency and implementation plans.

### **Building resilience through integrated development and humanitarian planning and implementation**

USAID's approach to resilience reflects the collective recognition by governments, regional institutions, USAID, other donors, and a wide array of humanitarian and development partners that continuing to treat people and places subject to recurrent crises as a perpetual humanitarian risk—rather than as a development priority—is extremely costly in terms of lost lives and livelihoods, economic growth, and high levels of humanitarian spending. In partnership with governments, regional institutions, and other humanitarian and development partners, USAID is helping the global humanitarian and development communities pivot from being reactive in the wake of disaster to making evidence-based investments that enable communities and households to minimize exposure to, adapt to, and recover quickly from inevitable shocks. The growing intensity and complexity of risks in the world—from climate change and variability and weather events linked to El Niño, to population dynamics, local and global price shocks, political instability and conflict—requires us to make this shift.

In late 2011, building resilience to recurrent crises emerged as a priority within USAID, prompted by large-scale drought emergencies in the Horn of Africa and the Sahel during which countless lives were lost and for which the U.S. Government provided more than \$1.5 billion in humanitarian response. USAID's resilience efforts focus on people and places caught at the intersection of chronic poverty and exposure to shocks and stresses, with an initial focus on places where this translates into repeat, large-scale humanitarian emergencies. USAID's resilience approach builds on and brings together: 1) existing capacities at the community and country level; 2) existing efforts on climate change adaptation, climate smart agriculture, disaster risk reduction, governance, and health; and 3) community and country ownership.

To date, USAID resilience efforts have focused on the Horn of Africa (Kenya, Ethiopia, Uganda, and Somalia), the Sahel (Niger, Burkina Faso, and Mali), and Nepal with a total investments of approximately \$300 million/year across these countries. However, the developmental rationale for investing in resilience and the utility of the concept extends to people and places across the developing world where risk, hazards and vulnerabilities constrain, threaten or otherwise undermine the sustainability of efforts to reduce poverty. Therefore, USAID is currently exploring opportunities to expand the resilience approach to a wider set of countries and regions, as well as working with a wider range of partners.

USAID's resilience investments support countries' plans and priorities by: 1) expanding economic opportunities; 2) strengthening governance through more effective natural resource,

conflict, and disaster risk management, and 3) improving health and human capital. Initial results from Kenya and Ethiopia include:

- Increased commercial livestock sales: In targeted areas of Ethiopia, private sector investment and growing exports have resulted in an increase in the value of livestock sales from \$6 million to \$67 million.
- Increased access to financial services: Nearly 70,000 small and medium-sized enterprises in targeted vulnerable areas of Ethiopia and Kenya have accessed loans.
- Improved management of 6 million hectares of rangeland in targeted areas of Ethiopia and Kenya through wet/dry season grazing agreements, communal management structures, the application of water harvesting technologies and other practices.
- More than 2.6 million people in northern Kenya are now covered by USAID-supported county-level disaster contingency plans through the National Drought Management Authority.
- More than 400,000 more households in Ethiopia and Kenya now have access to improved water sources and nutrition programs aimed at improving both child care practices and dietary diversity have reached over 2 million people in targeted areas of Ethiopia/Kenya.

### **Responsive development**

USAID's suite of resilience investments is also helping us respond more quickly, proactively, and systematically to El Niño. Through USAID's Disaster Risk Reduction activities, we are adjusting our interventions on a rapid timeline to take into account the current El Niño, one of the strongest in recorded history. The impact of this year's El Niño is exceeding the capacities of the most affected populations and their countries' ability to respond to crisis. Based on early warning and careful tracking of the progression of El Niño, USAID quickly mounted an integrated effort to forecast, plan, and respond to El Niño by: activating built-in mechanisms to inject emergency funds into development programs; mobilizing humanitarian assistance to the most affected people; and adjusting development efforts to mitigate the impact of El Niño and accelerate recovery. USAID is also working on a coordinated response with other donors to address the potentially devastating and destabilizing impacts of El Niño.

An example of this work is USAID's efforts to help drought-affected populations in Guatemala, Honduras, and El Salvador by providing almost \$15 million in food assistance, helping communities cope by supporting soil conservation and rainwater harvesting, and establishing savings and loan programs that can serve as a safety net. In Haiti, USAID collaborates with the government to address the immediate food needs of over 14,000 households through an electronic food voucher-based safety net system. In Ethiopia, USAID provided emergency funds through development programs to help households meet their immediate needs without selling assets—such as livestock—that provide a source of income and nutrition now and in the future. USAID is also distributing \$4 million in drought-tolerant seeds to help ensure that over 226,000 Ethiopian households can grow additional life-saving food in the coming months. And, in the Caribbean, the collaboration between USAID, NOAA and the Jamaican meteorological service and agricultural extension service to develop a seasonal drought forecast method for farmers has been adopted by the Caribbean Institute for Meteorology and Hydrology. The forecast method was used in 2014 and 2015 to help decision makers across the region respond to dry conditions driven by El Niño.

## **U.S. Domestic Experience**

In addition to supporting financial tools and finance-related approaches to help developing countries address loss and damage, as described above, the United States takes very seriously our own vulnerabilities to the adverse effects of climate change. We engage in a number of strategies to address these vulnerabilities, including national adaptation planning that links federal and subnational governments; micro-, meso- and macro-level insurance; and, disaster and recovery response. In developing good practices related to financial tools for addressing climate-related impacts, we present the following case studies, which could be instructive for other countries building comprehensive approaches to addressing loss and damage.

### **Federal government sets high standards of resilience**

Between 1980 and 2013, the United States suffered billions of dollars in flood-related damages. Costs borne by the Federal government in response to flooding are more than any other hazard. Flooding accounts for approximately 85% of all national disaster declarations. With climate change, land use change, increased coastal development, population growth, and other development drivers, we anticipate that flooding risks will increase over time. The damage can be particularly severe to U.S. infrastructure, including buildings, roads, ports and industrial facilities.

On January 30, 2015, the President signed an Executive Order focused on improving resilience to flood risk and establishing a federal flood risk management standard (“Standard”). The Executive Order also updated a 1977 Executive Order on Floodplain Management. The Standard requires all future federal investments in and affecting domestic floodplains to meet a baseline level of resilience by considering current and future flood risk. The Executive Order applies to all instances where taxpayer dollars are used to build new structures and facilities in floodplains or to rebuild those that have been substantially damaged. In implementing the Standard, federal agencies will have the flexibility to select one of three approaches, or a hybrid approach, for establishing the flood elevation and hazard area they use in siting, design, and construction:

- \*Utilizing best-available, actionable data and methods that integrate current and future changes in flooding based on science,
- \*Two or three feet of elevation, depending on the criticality of the building, above the 100-year, or 1%-annual-chance, flood elevation, or
- \*500-year, or 0.2%-annual-chance, flood elevation.

Federal agencies across the government are currently updating their procedures and regulations to implement the Federal Flood Risk Management Standard. One of the challenges federal agencies are currently experiencing in implementing the Standard is lack of availability of detailed information on flood risk and ground elevations at specific, often rural, locations.

### **Stakeholder engagement in decision making**

In designing the Standard, the federal government undertook a significant stakeholder consultation process. This process allowed the public the opportunity to better understand the Executive Order and its application to federally funded projects. Federal agencies provided input

regarding how applying the Standard would improve resilience for many projects, eg, roads. The stakeholder consultation process also allowed for clarification on any misunderstandings about the Standard. This process helped alleviate some of the public's concerns about the potential application of the new Standard.

### **Incentivizing rigorous risk reduction and management**

As stated previously, the provision of assistance in times of disaster is a critical financial tool in addressing loss and damage. That said, experience suggests that investing in risk reduction significantly reduces<sup>2</sup> the amount needed for humanitarian assistance and, more importantly, saves human lives. The U.S. Federal Emergency Management Agency (FEMA), which leads the U.S. Government's domestic efforts to prepare for, protect against, respond to, recover from and mitigate all hazards, provides emergency relief funds when a federal disaster is declared by the President. In response to recommendations from the U.S. Government Accountability Office and Department of Homeland Security's Inspector General calling for reducing the burden on taxpayers related to the provision of disaster assistance, FEMA is considering the establishment of a disaster deductible. The disaster deductible would require a predetermined level of financial or other<sup>3</sup> commitment for disaster risk reduction or disaster planning, including for contingency finance, from a state, before FEMA would provide disaster response assistance under the Public Assistance Program and as by a Presidential Major Disaster declaration. FEMA believes the deductible model would incentivize U.S. states to make meaningful improvements in risk reduction, disaster planning, and fiscal capacity for disaster response and recovery, while contributing to more effective stewardship of taxpayer dollars.

If the disaster deductible is approved, U.S. states could receive credit toward their deductible requirement through proactive prevention actions such as adopting enhanced building codes, establishing and maintaining a disaster relief fund or self-insurance plan, or adopting other measures that reduce the state's risk from disaster events. The deductible model would increase stakeholder investment and participation in disaster recovery and rebuilding for future risk, thereby strengthening the nation's resilience to disaster events and reducing the cost of disasters in the near and long term.

FEMA is currently undertaking a consultation process on the proposed disaster deductible and is seeking comments from domestic stakeholders on all aspects of the concept until March 21, 2016. It should be noted that the program, if implemented, would not impact U.S. humanitarian assistance to foreign countries.

We appreciate this opportunity to share some good practices, lessons learned and challenges from the United States related to financial tools and finance-related approaches for addressing

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<sup>2</sup> See, eg, <http://www.nibs.org/?page=mmc> and [http://www.undp.org/content/undp/en/home/ourwork/get\\_involved/ActNow.html](http://www.undp.org/content/undp/en/home/ourwork/get_involved/ActNow.html)

<sup>3</sup> Other types of commitments could be adoption of stronger building codes or exceeding basic requirements in floodplain management.

U.S. Submission to the Excom  
14 March 2016

loss and damage. We look forward to collaborating with the Executive Committee as it undertakes further work on this topic.