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REPORT OF THE CHAIRPERSON OF THE AFRICAN RISK CAPACITY (ARC) GOVERNING BOARD ON 3RD ARC CONFERENCE OF THE PARTIES

Report on the African Risk Capacity (ARC) Specialized Agency

Pursuant to a decision by the AU Assembly of Heads of State and Government (Assembly/AU/Dec.417(XIX)) of 16 July 2012, the ARC was established as a Specialized Agency of the African Union. This report summarizes the work of the Agency, the establishment of its financial affiliate, ARC Insurance Company Ltd capitalized at US $200 million and finally outlines the payments to AU Member States in the Sahel in 2014.

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1. BACKGROUND

The African Risk Capacity (ARC) was designed to improve the capacity of AU Member States to manage natural disaster risk, adapt to climate change and protect food insecure populations. To do this, the ARC offers weather insurance to participating governments through its commercial affiliate, the **ARC Insurance Company Limited (ARC Ltd or the Company).** This African-owned financial entity uses ***Africa RiskView***, an advanced satellite weather surveillance and software to estimate and trigger readily available funds to African countries hit by severe weather events.

As currently structured, the international system for responding to disasters is not as timely or equitable as it could be. Funding is secured on a largely *ad hoc* basis after disaster strikes and only then can relief be mobilized toward the people who need it most. In the meantime, lives are lost, assets are depleted, and development gains suffer major setbacks – forcing more people into chronic destitution and food insecurity in the least developed countries.

Because such events do not happen in the same year in all parts of the continent, pan-African solidarity in the creation of a disaster risk pool like ARC is financially effective. Pooling risk across the continent significantly reduces the cost to countries of emergency contingency funds, while decreasing reliance on external aid. By merging the traditional approaches of disaster relief and quantification with the concepts of risk pooling and risk transfer, ARC will help create a pan-African disaster response system that meets the needs of those affected in a timelier and more efficient way and provides an important step forward in creating a sustainable African-led strategy for managing extreme climate risks.

ARC is an African solution to one of the continent's most pressing challenges, transferring the burden of climate risk away from governments – and the farmers and pastoralists whom they protect – to the ARC that can handle that risk much better. Pursuant to a **decision by the AU Assembly of Heads of State and Government (Assembly/AU/Dec.417(XIX)) of 16 July 2012**, 41 countries participated in the ARC Conference of Plenipotentiaries in Pretoria, South Africa. Upon signature of the treaty by 18 AU Member States, ARC was established as a Specialized Agency of the African Union on 23 November 2012. Seven additional States have since signed.

Table 1: ARC Establishment Agreement Signatories

Original Signatories (23 November 2012)

1. Burkina Faso
2. Burundi
3. Central African Republic
4. Chad
5. Republic of Congo
6. Djibouti
7. The Gambia
8. Guinea
9. Liberia
10. Libya (with reservations)
11. Malawi
12. Mozambique
13. Niger
14. Rwanda
15. Sahrawi Arab Democratic Republic
16. Senegal
17. Togo
18. Zimbabwe

Additional Signatories (date signed

19. Kenya (28 January 2013)
20. Mauritania (28 January 2013)
21. Côte d'Ivoire (6 February 2013
22. Comoros (15 February 2013)
23. Gabon (30 January 2014)
24. Madagascar (31 January 2014)
25. Nigeria (4 December 2014

This report summarizes the operationalization of the Agency, the establishment of its financial affiliate, ARC Insurance Company Ltd, capitalized at US $200 million and, finally, outlines the drought insurance payouts of up to US $30 million due to AU Member States in the Sahel in 2014.

2. OPERATIONALIZATION OF ARC AGENCY

2.1 Institutional Structure

In May 2012, the AU Commission Office of the Legal Counsel held a validation workshop on the ARC Establishment Agreement – the primary purpose of which was to develop a draft treaty text for consideration by Member States and to propose a suitable institutional structure for ARC's objectives. From this discussion emerged ARC's two-tiered institutional structure, which is unique among international organizations. The parent body, ARC Agency is governed by the signatories to the treaty, which form the ARC Conference of the Parties (CoP). The CoP elects a Governing Board, which is currently chaired by Dr Ngozi Okonjo-Iweala, Coordinating Minister for the Economy and Honourable Minister of Finance of Nigeria. The Agency Secretariat offers quasi-governmental functions such as capacity building services to governments; approval and monitoring contingency planning; and, in the future, could provide advice and assistance to governments regarding reserve funds and contingency credit. ARC Insurance Company Limited (ARC Ltd) is the Agency's financial affiliate incorporated as a mutual not-for-profit insurer in regulated under the national laws of Bermuda, as decided by the first ARC CoP held in Dakar, Senegal in February 2013.[1] The Company is owned by the policy holders and capital contributors to carry out insurance functions, transferring risk to the markets, and managing other financial and asset management tasks. The ARC Ltd Board of Director is chaired by Dr Lars Thunell, former Executive Vice President and CEO of the International Finance Corporation (IFC).

2.2 Member State Capacity Building

Prior to taking out insurance, countries enter into Memoranda of Understanding (MoU) for capacity building services from the ARC Agency Secretariat. This is a fee-for-service structure whereby the ARC facilitates the salary of a dedicated ARC Coordinator (government employee) and focused time of selected government experts in meteorology, agriculture, food security, contingency planning and finance in return for certain deliverables in the "pre-participation programme." Throughout the 12-18 month programme, the ARC Secretariat guides the in-country team in customizing ARC's proprietary weather risk quantification software, *Africa RiskView,* building a contingency plan for early intervention to affected populations in the case

[1] By decision of the Conference of the Parties and in accordance with Article 11 of the treaty, the ARC's financial affiliate was licensed in Bermuda, until an "equally favourable legal and regulatory regime exists in an AU Member State."

of a disaster and finally assisting the country in selecting the optimal coverage and structure of its insurance contract.

Five countries have negotiated insurance contracts with ARC Ltd: Kenya, Niger, Senegal, Mauritania and Mozambique. Countries that participate in the first pool will likely continue coverage with the second pool in May 2015. The following additional countries have expressed interest in joining the continental risk pool in the future: Burkina Faso, Chad, The Gambia, Lesotho, Madagascar, Malawi, Mali, Rwanda and Zimbabwe.

The creation of the ARC is a transformative moment in efforts to use aid more effectively and has the potential to transform disaster risk management on the continent. With the ability to scale to a multi-billion dollar portfolio, ARC has the potential to offer drought, flood, and cyclone coverage to 20 plus countries by 2020.

3. ARC INSURANCE COMPANY LIMITED (ARC LTD)

3.1 ARC Ltd First Insurance Portfolio

Following a series of consultations with prospective policyholders (AU Member States) and capital contributors in late 2013 and early 2014, the ARC Ltd bylaws were agreed and the Company was incorporated in January 2014. KfW German Development Bank approved a EUR 50 million contribution in "returnable capital" to ARC Ltd for seed capital to be provided over a two-year period, with the first tranche of EUR 30 million transferred on signature of the Capital Contribution Agreement in March 2014. Further, in March 2014, DFID approved a GBP 100 million allocation to the ARC from the United Kingdom, comprised of GBP 90 million to ARC Insurance Company Ltd[2] in "returnable capital" to be provided over a four-year period.

ARC brought Africa's first continental risk pool to market in April 2014 providing $135 million in drought risk cover to five countries: Kenya, Mauritania, Mozambique, Niger and Senegal. While much of this risk was retained by ARC Ltd, a panel of 12 reinsurers took on the $55 million placed on the international weather risk markets.

Table 2: 2014/2015 Country Coverage (USD) and Seasons Insured

COUNTRY	PREMIUM	COVERAGE LIMIT	DATES OF SEASON INSURED
Niger	$3,000,000	$30,000,000	1 May 14 – 31 Oct 14
Senegal	$3,600,000	$30,000,000	11 May 14 – 10 Dec 14
Mauritania	$1,400,000	$9,000,000	1 July 14 – 20 Nov 14

[2] The initial GBP 30 million tranche of capital was received by ARC Insurance Company Ltd on signature of the Capital Contribution Agreement in March 2014.

Kenya EAR 2*	$4,500,000	$30,000,000	1 Aug 14 – 31 Jan 15
Mozambique	$500,000	$5,000,000	21 Oct 14 – 20 May 15
Kenya EAR 1*	$4,500,000	$30,000,000	1 Feb 15 – 31 Oct 15

*East Africa Rainfall (EAR) Season – Kenya experiences two agricultural seasons and therefore has two separate insurance policies

3.2 **Potential** Payouts in 2014

Given the significant drought in the Sahel this year, insurance payouts are projected to the following countries immediately after the last dekad (10 day period) of the agricultural season covered in the ARC contract [NB: payout figures below are at the time of writing – November 2014]:

- Niger (end of season: October 31, 2014) due ~US $3.4 million;
- Mauritania (end of season: November 20, 2014) likely due ~US $6.3 million;
- Senegal (end of season: December 20, 2014) likely due ~US $16.2 million.

Niger: While the latest food security updates from FEWSNET and others suggest that the overall cereal production in Niger is likely to be average to above average, due to good rains in August and September, localised areas of south-eastern Niger are expected to face some food security problems, due to the effect of a long dry spell during the rainy season. *Africa RiskView* reflects issues in these pockets and indicates that a small payout to Niger of approximately US $3.4 million is now confirmed.

Senegal: Given the poor rains during the sowing window, which ended 31 July 2014, it was already clear that Senegal would experience a poor harvest. This projected deficit was reflected in a guaranteed minimum payout that currently stands at US $11.5 million. Rains improved only towards the middle of the season – in some areas where planting was successful – and therefore the expected payout is approximately US $16.2 million.

Mauritania: Similar to Senegal, Mauritania is on track to experience one of its worst agricultural seasons since 2001. In the normally productive regions in the South, the drought index shows that crops are receiving, in some cases, only 10-20% of the water required for an optimal harvest. While the final drought response cost, which determines whether the country is eligible for a payout by ARC Ltd, will only be available at the end of the season in mid-December 2014, the current estimate is that a US $6.6 million payout is highly likely.

4. DIRECTOR GENERAL SEARCH PROCESS

The CoP requested the Governing Board to oversee the search for a regular term ARC Agency Director General to take over from the founding Director General Dr. Richard Wilcox at the end of his term of office. The CoP requested that the Board submit three to four nominees for its consideration. To perform this function, the Board established a Director General Search Committee to assist the Board in conducting its research. The committee included three members of the Board and representatives who were invited by the Board to join including, the African Union Commission, the UN World Food Programme, DFID and the Swedish International Development Authority.

ARC received over 200 applications following a Note Verbale sent to all permanent missions in Addis Ababa and advertisements in prominent media outlets including *The Economist, Jeune Afrique, the Financial Times, the Guardian and Le Monde.* An executive search firm was engaged to assist with the review of the CVs and to develop an applicant evaluation matrix. The search firm identified 23 qualified candidates, which were reviewed prior to the fourth meeting of the Governing Board on 16 June 2014 in Abuja, Nigeria. The Board requested the Search Committee to conduct interviews with the eight shortlisted candidates. On 10-11 July 2014, in accordance with the Framework for the Selection of Director General Candidates and the Terms of Reference and Search Guidelines approved by the COP, the Search Committee interviewed the candidates for the position of Director General of the ARC Agency in Johannesburg, South Africa. The three strongest candidates were selected and recommended for a second interview to the Board. On 23 October 2014, during their fifth meeting held in Abuja, Nigeria, the Board conducted the second set of interviews of the top candidates identified by the Search Committee and will provide a ranked list to the CoP. The CoP will make the final decision regarding the next Director General of the ARC Agency during its next meeting, in January 2015 on the margins of the AU Summit in Addis Ababa.

5. RESEARCH & DEVELOPMENT AND THOUGHT LEADERSHIP

5.1 Modelling of New Risks

The ARC Group was designed to be a multi-peril initiative, covering natural hazards affecting all parts of Africa. While the Company currently offers drought insurance to African sovereigns, during initial engagements between ARC Agency and potential ARC participant countries, flood risk was identified as a high priority for many countries. ARC Agency has already started the process of developing the first flood index in the world and hopes to offer flood insurance in 2016. Tropical Cyclone coverage should come online as well in later 2015 or early 2016.

5.2 Sovereign Disaster Risk Financing Ratings Mechanism

Given the increasing role of public sector contingent fund providers as well as rapidly growing interest of the international reinsurance business in the commercial provision of such funds to developing countries, the ARC sees the need for a ratings mechanism to ensure that providers can be confident in the utility of countries taking risk insurance as well as their ability effectively to deploy such funds. The rating would aid the country's leadership in their decisions on disaster finance as well as mitigate the fund providers' reputational risks in entering these transactions, opening up access to international risk markets – particularly important in light of climate change's potential to increase the severity and frequency of natural disasters.

The Sovereign Disaster Finance Ratings (SDFR) mechanism would be designed to be an input to the Peer Review Mechanism to assess the adequacy of financial reserves, including insurance, versus quantified natural disaster risks and evaluate countries' ability to absorb funds accountably and deploy assistance effectively to vulnerable populations. The SDFR would provide several key benefits for ARC's Members, including attracting disaster financing through ex-ante assessment, incentivising improvement of broader risk management platforms and comparing/differentiating financial and operational disaster preparedness.

This proposal has been submitted to countries for consideration and debate at the World Conference on Disaster Risk Reduction to be held in March 2015 in Sendai, Japan.

5.3 Extreme Climate Facility (XCF)

Significant investments in resilience and adaptation will be necessary in Africa over the coming years to manage the impacts of climate change, particularly for chronic, year-on-year risks faced by millions of vulnerable people across the continent. The capital required for adaptation investments is substantial, with the World Bank estimating a global cost of USD 70-100 billion per year through 2050 for developing countries to meet their needs.[3] However, despite the need at scale, such funds have, to date, not been forthcoming in the magnitude required.

The ARC Agency was specifically requested by African Union Conference of Ministers of Finance in March 2014 to develop a proposal for a mechanism by which African states can gain access to financing to respond to the impacts of increased climate volatility. To meet the long-term needs of both the adversely affected countries in sub-Saharan Africa as well as the industrialised governments, a new financial facility that can utilise both public and private sector capital is required. Such

[3] World Bank, 2010: Economic of Adaptation to Climate Change: Synthesis Report (accessible online at http://documents.worldbank.org/curated/en/2010/01/16436675/economics-adaptation-climate-change-synthesis-report)

a facility would avoid the current and persistent impasse between dialogue and action by securing direct access for African governments to much needed climate finance based on the demonstrated needs for enhanced adaptation measures. Such a facility would also provide a fair and objective mechanism for the allocation and distribution of climate finance and prioritisation of the geographical location of the available investment flows.

Building on the *Africa RiskView* and insurance work to date and on the climate change simulations conducted by the ARC Technical Team and the Italian National Agency for New Technologies, Energy and Sustainable Economic Development (ENEA) over the period 2010-14, **the ARC Secretariat is proposing that a feasibility study be undertaken with a view to designing an Extreme Climate Facility (XCF) in order to provide African governments with direct access to climate finance for adaptation in the event that the frequency and magnitude of severe weather events increases.**

Such a facility would track extreme weather events in Africa over time using an objective index, potentially including excess severity and frequency of heat, drought, rain or other extreme weather events. Payments to countries from the facility would be entirely data-driven over a 30-year period; if there is no significant increase in extreme events over current climatology over that time, as measured by the index, no payment is made. Should payments be made, funds would be used for investments in disaster risk reduction, the agricultural sector and/or climate change adaptation measures specified in pre-defined country-level adaptation plans. The XCF would function as an additional financing mechanism for countries already managing their current weather risks through ARC Ltd – ensuring that investment and risk management are harmonised in a holistic climate-resilience approach.

The ARC Secretariat in currently in the process of securing funding for such a study with the aim of conducting work to develop the XCF concept and design in 2015.

2015

Report of the chairperson of the African risk capacity (ARC) governing board on 3rd ARC conference of the Parties

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