A challenging experience:

The African Risk Capacity – Insurance against Drought for African countries

http://www.africanriskcapacity.org/

African Risk Capacity
Sovereign Disaster Risk Solutions
A Specialized Agency of the African Union

"from managing crises to managing risks"

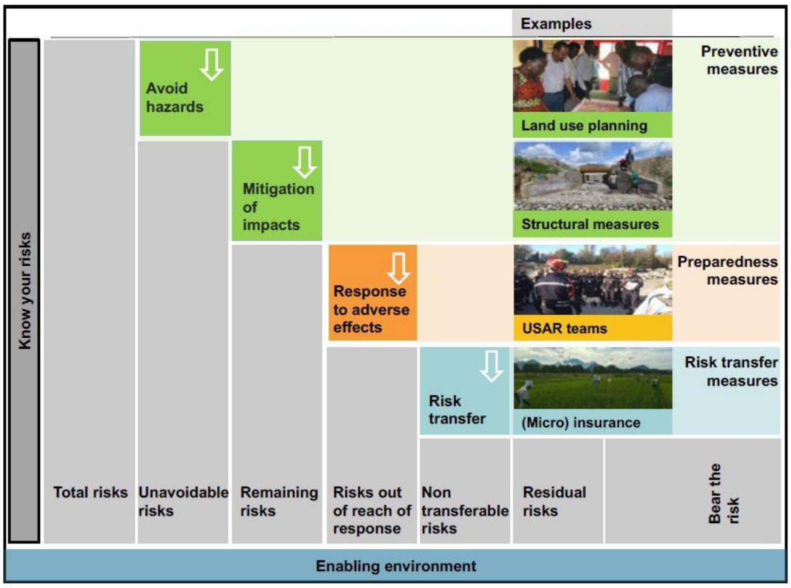
What is ARC

The African Risk Capacity (ARC) is a Specialized Agency of the African Union (AU), established in July 2012. It helps African governments to improve their capacities to better plan, prepare and respond to natural disasters such as drought, river floods, tropical cyclones or outbreak of epidemics.

The ARD is comprised of two entities: the ARC Agency and the ARC Insurance Company Limited. The Agency provides African governments with capacity building services and access to state-of-the-art early warning technology, contingency planning. Once a country underwent the capacity building programme, it qualifies for signing insurance policies.

ARC – a key element of Disaster Risk Management

ARC is a "risk transfer mechanism" and as such one of the elements of the "risk staircase" in Disaster Risk Management (see picture):



Source: SDC Guidelines DRR, 2018

Based on a risk analysis, the total risk is consecutively reduced by prevention/mitigation and preparedness measures and transferred or shared. The residual risk of disaster has to be borne.

What makes ARC innovative?
The traditional system for responding to natural disasters is not as timely or equitable as it should or could be, with much of the cost borne by farmers or pastoralists. International assistance is secured largely on an ad-hoc basis after disaster strikes, and governments are forced to reallocate funds in national budgets from essential development activities to crisis response. Only then can relief be provided and it is often too late. Lives are lost, assets are depleted, and development gains reversed, forcing more people into chronic hunger, malnutrition and destitution across the continent.

ARC uses a different approach. It aims to achieve more efficient and effective responses by linking early warning systems to contingency plans, contingency funds and credible national response mechanisms. ARC Ltd uses satellite weather surveillance based on which it estimates the population affected by drought and the associated response costs. Pay-outs are triggered to countries where the estimated response cost at the end of the season exceeds a pre-defined threshold that is specified in the insurance contracts. ARC pay-outs arrive in the National Treasury within 2-4 weeks of harvest, so that the first assistance can start to reach needy households within 120 days, the time period at which reduction in household consumption and asset depletion at the household level begins.

1 USD spent through ARC saves 4.40 USD in post-disaster response costs.

Looking at the case of Malawi, a 1 in 10 year drought out 4 percent of annual GDP growth under the current risk management paradigm.

Surveys after an ARC pay out in Mauritania found that 40 percent of respondents did not leave their rural homes because assistance was delivered quickly.

Premium financing - the challenge number one
Premium payment is the single most determining critical factor of the ARC. The factors are:
- fiscal (limited capacity of countries to allocate scarce public finances to the insurance),
- political (changing political priorities in the wake of elections and as a consequence of staff changes),

– technical (expectations as seen “from the ground” do not match with the measurements and observations from “objective” gauging from satellites or ground measuring devices, typical for parametric insurances),
– governance related (not suitable policies in place, prohibiting public institutions, in some cases, to sign insurance policies and pay corresponding premiums)
– market related (competition with other risk transfer options).

As a matter of principle of ARC, countries signing insurance policies ought to finance the premiums out of their ordinary budgets, most appropriately from drought resilience management budgets. However, only some countries are in a position to do so. Overall and referring to the feasibility study established in 2010, this principle does not respond do the lacking capabilities of the majority of the African countries.

The ARC together with partners develops options that may assist countries in paying insurance premiums:

– The African Development Bank launched the “Africa Disaster Risk Financing Programme”. Through this programme, countries might access both grant and concessional loan funds, *inter alia* to finance their premiums. These funds are part of the country envelope and, therefore, need to be part of the countries’ overall portfolio with the bank, requiring trade-off decisions.
– The World Bank “Global Risk Financing Facility” includes supporting governments to access risk pools such as the ARC and to co-finance premiums for ARC products.
– Humanitarian actors through the so-called REPLICA model may double the insurance coverage by signing an identical country insurance policy and paying the additional premium. This option responds to the fact that the insurance covers the risks the humanitarian actors face: through the insurance the need for emergency assistance gets reduced.

ARC Strategy 2.0

“The ARC is at a crossroads” as the chairperson of the ARC expressed. For the first time since its inception, the insurance pool 2018/19 failed and resulted in a loss. Out of three policies signed only one country managed to provide a part of the premium. The two other ones failed to do so in time.

In the light of the experiences made, ARC will formulate its strategy ARC 2.0 along the following lines of thought:

– Offer of policies to more localized risks, at subnational level
– Cooperation (co-insurance) with local/national insurance (private) companies
– Link to (national, regional) contingency funds

Would SDC invest humanitarian money in the ARC?

For SDC there are good reasons to participate in the further development and consolidation of the ARC and to learn from it. Despite the “downsides”, ARC has successfully introduced a private-public insurance model and mechanism for transferring natural disaster risks combined with building disaster risk capacities / contingency planning at country level.

Given the assumed positive side effect of such a risk transfer mechanism as well for the emergency aid, SDC in its continued partnering with ARC may consider as well using humanitarian funds.

The Partners of ARC