

African Risk Capacity – Response to ActionAid’s Flawed Claims

ActionAid recently issued a report criticising the expansion of climate risk insurance markets for the poor and vulnerable and urging African Risk Capacity (ARC), the G7, World Bank, Insurance Development Forum and others to halt their work in this space. ActionAid’s stance and recommendations, as presented in the report, are misguided.

In an attempt to validate its position on the issue, ActionAid suggested that ARC’s sovereign disaster risk insurance failed in Malawi. This is simply untrue and many of ActionAid’s claims regarding this issue are inaccurate or misleading.

ActionAid’s assumptions about ARC and its open risk modelling platform, *Africa RiskView*, which were based on one season in one Member State, were flawed and do not represent the true picture of ARC, its services, or even what occurred in Malawi during the period in question.

ARC has a proven track record of helping to protect millions of people against the devastating impact of drought and extreme weather on the continent.

Below are the facts.

African Risk Capacity

ARC was established by the African Union (AU) to work with African governments to find better ways to finance responses to disasters on the continent and reduce the level of reliance on the traditional humanitarian approach. Importantly, it was established also to work with AU countries to strengthen public policy and climate risk management systems.

ARC provides climate-related disaster insurance to African governments – managed through its insurance affiliate, ARC Insurance Company Limited (ARC Ltd). Using modern finance mechanisms such as risk pooling and risk transfer, ARC is creating pan-African climate response systems. By pooling risks, countries can reduce the cost of insurance by about half, as drought is very unlikely to affect the whole of Africa at any one time. With an insurance payout triggered at times of crisis, ARC’s offering provides governments with fast access to funding. The government can then quickly implement previously agreed-upon, rapid response plans to help the affected population.

In its first three years, ARC paid out USD \$34 million to Senegal, Niger, Mauritania and Malawi to support communities affected by drought. These resources have assisted more than two million people and protected close to one million cattle.

In addition to its insurance offering, ARC’s cutting-edge technology and capacity-building efforts have enabled countries to monitor climate indicators and predict response costs, while its disaster

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preparedness efforts help African governments pre-empt the devastating effects of drought before development gains are reversed and lives are lost.

ARC is helping to create a sustainable African-led strategy for addressing some of the continent's most urgent challenges.

Malawi's 2015/16 Insurance Payout

Malawi purchased an insurance policy with ARC for its 2015/16 crop season, during which time the country faced a severe drought. Although funding through ARC is designed to be delivered swiftly in such cases, a payout was not immediately triggered. ARC's payouts are based on the output of *Africa RiskView*, the open risk modelling platform developed by ARC and customised specifically for each country and crop season in close cooperation with an in-country government team. In the case of Malawi, the customised *Africa RiskView* model indicated far lower numbers of drought-affected people compared with the actual impact of the drought on the ground. Immediately recognising there was an issue, ARC initiated a technical review process to identify the causes.

As part of its thorough review, the ARC team conducted a number of field missions and meetings with the Malawi technical working group and other partners in-country. ARC also commissioned the Centre for Agricultural Research and Development (CARD) at the Lilongwe University of Agriculture and Natural Resources in Malawi to carry out an independent household survey and conduct farmer focus groups to determine potential sources of the discrepancy.

It was determined that farmers had been growing a different variety of maize in significant and increasing amounts in the recent past than initially selected as the reference crop in Malawi's customisation of *Africa RiskView*. It also was determined that the out-of-date information on farming practices prevented the model from accurately replicating conditions on the ground at the end of the season. Using incorrect critical information in the model resulted in inaccurate output from *Africa RiskView*.

Based on these findings, the *Africa RiskView* customisation was revised to reflect the most recent farming practices. The result was an assessment that aligned with the drought's actual food security impact on the ground. Once Malawi's insurance coverage information was adjusted to be consistent with the corrected customisation, a payout of USD 8.1 million was triggered to the Government of Malawi, based on the magnitude and severity of the drought event and the amount of insurance coverage purchased by the government, as is the case under all of ARC's parametric insurance policies.

ARC's *Africa RiskView* model performed as it was designed to and, when informed by accurate data, was able to correctly capture the situation on the ground.

ARC has since worked with the Government of Malawi to ensure that the best possible crop and other critical data is available in order to properly reflect the reality on the ground in order to assess risk in the most precise way.

With each season that ARC is active, there are invaluable lessons learned. As an example, ARC now is taking extra steps with each participating country to verify inputs provided to the *Africa RiskView* model prior to completion of the customisation process.

ARC Ltd's insurance policies, which are legally binding contracts between the Member State and ARC, do not include a negotiation component with respect to payouts as the policies are based on an objective index that captures the severity of an event. If the index reaches a pre-defined threshold, a payout is triggered (the amount of which grows as the severity of the event, captured by the index, increases); if it is not reached, there is no payout. The index is monitored by both ARC and Member States, as well as by external parties.

As is the case with all ARC payouts, the payout to Malawi was not the result of negotiations, nor was it done on an ex gratia basis. The payout was parametrically triggered and occurred as the result of a correction of erroneous data, which allowed for the AfricaRisk View model to function as intended under the terms of the contract.

The funds resulting from the USD 8.1 million payout were instrumental in plugging a gap in the response activities already being implemented by the Government of Malawi. This included cash transfers to affected households and replenishment of the country's strategic grain reserves, and is estimated to impact 810,000 people once completed.

ARC's Value

As the effects of climate change continue to expand, Africa is increasingly facing the devastating impact of extreme weather events. When populations are in dire need of support, too often a government's only choice is to turn to international aid, which involves a cumbersome mobilisation process and, by the time resources and assistance arrive, too often lives have been lost, assets depleted, and development gains have suffered major setbacks – forcing more people into poverty and food insecurity. ARC offers an important addition to the options available and enables a government to be proactive in dealing with its disaster risk.

ARC's offering covers three critical areas: financing, early warning, and planning. Not only does ARC provide sovereign disaster risk insurance, including rapid access to funds when climate disasters strike, ARC's technology and capacity-building efforts also enable countries to monitor climate indicators and forecast response costs, while its disaster preparedness efforts help governments plan for and mitigate the devastating effects of drought and other climate disasters.

When ARC was being developed, several detailed economic cost-benefit analyses were completed by international experts, which helped guide its final operating model. It was recognised that ARC's value proposition could be maximised only through the integration of risk assessment, early warning, risk reduction through contingency planning, and risk financing through parametric insurance. This crucial combination allows for early, pre-planned response, which has been shown to be greater than four times more cost-effective than the appeals-based drought response historically used to address Africa's food security shocks.

ARC's offering enables African countries to be equipped to manage climate-related disasters to a greater extent than previously experienced, while providing access to funding that is much more immediate.

Despite the many benefits, ARC's product is not designed to cover every aspect of a Member State's response to natural disasters and weather events or the entirety of the costs involved. It

is one part of a suite of services Member States should rely on to be fully prepared. It is not intended to be, nor does it claim to be, a replacement for large-scale international humanitarian interventions.

The pricing of ARC's insurance must allow for the sustainability of the mutual insurance company underwriting the risk. All premium-paying countries are members and effective owners of the mutual insurance company (ARC Ltd) and benefit from being part of a diversified risk pool and from the remarkably cost-effective access to global risk markets made possible through ARC Ltd.

It is important to note that one of the unique and vital elements of ARC is that impact assessment figures – along with insurance coverage – are based on populations affected by drought in the current season alone and does not include prior year droughts or other sources of food insecurity like high food prices or floods. The food insecurity figure that often was quoted for Malawi for 2015/16, 6.5 million, represented a comprehensive accounting of the entire situation, rather than the effect of that season's drought specifically. Being able to focus on and assess the precise *drought* impact not only helps to determine payout triggers and amounts, it also ensures that ARC is able to provide targeted, effective support.

Following the drought in the Sahel in 2014, ARC insurance policies triggered payouts in the amount of USD 26.3 million to the governments of Senegal, Niger and Mauritania. Collectively, the three governments had paid USD 8 million in premiums. The payout funds supported response efforts to assist more than 1.3 million people and over 900,000 cattle and were used toward scaling up targeted food distribution activities, subsidising the purchase of cattle feed, scaling up cash transfer programmes and replenishing strategic grain reserves. For each of these countries, the impact assessments of the *Africa RiskView* model were very much in line with seasonal outcomes – as documented by both governments and external organisations.

Contrary to ActionAid's recommendation, Member States and others with expertise have indicated that a budget allocation is not a feasible alternative to ARC's offering for many governments in the region, as their budget deficits and needs are too serious to commit to "rainy day" savings plans even if the funds are available. Further, it's more beneficial for governments to pool their collective funds, rather than each setting them aside independently. The aggregate funding needed to cover all the countries in the pool will be less than the sum of the countries' individual funding needs. This is because each country in the pool is geographically and climatically different, so the chance that all countries in the pool would need funds at the same time is very low and the funding and risk can therefore be shared across countries. Therefore, a government can leverage its funding through a risk pool like ARC's and ensure that when disaster strikes, a needs-based, lump-sum payout will be made to it, eliminating the need for the government to put aside such a large amount of savings.

Transparency at ARC

With *Africa RiskView*, ARC has the most transparent and accessible risk assessment model in current use for parametric insurance.

ARC works hand in hand with Member States. It provides contingency planning and risk financing support, as well as the unique customisation of *Africa RiskView*, with full transparency and in full cooperation with governments, in order to build the best possible solution for a nation's needs.

Each country-specific ‘model’ used to underpin a parametric insurance contract undergoes a lengthy customisation process annually, led by the Member State in conjunction with ARC, so that the prior year’s outcome and any new data can be taken into account. This is unique in the insurance context; no other risk assessment model is updated as frequently or with such substantial input from the client.

ARC works hard to make sure governments understand the disaster risk they face. This is an open, collaborative process between ARC and the Member States.

ARC provides ongoing *Africa RiskView* training to Member States and external parties, and access to the software is provided to all Member States as well as other key partners and stakeholders. ARC works to ensure that representatives from Member States are well-trained in the operation and understanding of *Africa RiskView*, in order to take full advantage of it, including using the platform as an early-warning tool.

ARC’s insurance vehicle, ARC Ltd, is a mutual insurance entity with policy holders (African governments) and international partners KfW Development Bank and the UK Department for International Development (DFID) forming the membership of the company. A rules-based approach to the issuance of insurance contracts is included in the bye laws of the company to ensure fairness and transparency for all participating countries. In the case of Malawi, once the model customisation was corrected, the change to the insurance policy was reviewed and unanimously approved by the members of ARC Ltd – African governments/policyholders, KfW, and DFID. Only then was a payout made to Malawi, again demonstrating the transparency with which ARC operates.

This step, which followed the necessary measure of undertaking an investigation with partners in Malawi regarding the discrepancy in the *Africa RiskView* output, required an investment of time and resources on ARC’s part and – crucially – patience on Malawi’s part, all of which ensured that this important process was handled properly and transparently.

Additionally, ARC regularly collaborates with other institutions. In fact, the core methodology for ARC’s drought risk module is that most frequently and commonly used by agro-meteorologists and other specialists across Africa. It is the view of ARC that it is in the best interests of the entire continent to widely build skills, know-how and commitment in the field of climate risk preparedness.

Moving Forward

ARC maintains a strong relationship with all Member States, including the Government of Malawi, and discussions continue regarding ARC’s critical role in strengthening Malawi’s risk management and financing system. While not a participant in the current ARC risk pool, the Government of Malawi has publicly spoken about the benefits of ARC and has expressed interest in participation in future ARC pools.

ARC continues working with its partners, including its valued Member States, to develop the most effective approaches to building African resilience, preparedness and self-sufficiency in the face of climate-related disasters.