African Risk Capacity

The African Union's African Risk Capacity (ARC) is a comprehensive, integrated solution to tackling the impact of natural disasters on vulnerable people. ARC transfers the burden of weather risk away from governments, enabling them to build resilience and better plan, prepare and respond to extreme weather events.

By 2020, ARC aims to scale up to 30 countries, with up to $1.5 billion of coverage against drought, floods and cyclones.

Why was the African Risk Capacity established?

Historically, Africa and its partners have lacked the appropriate financial mechanisms to respond effectively to natural disasters. As currently structured, the system for responding to natural disasters is not as timely or equitable as it should or could be. International assistance through the appeals system is secured on a largely 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 mobilised toward the people who need it most – and it is often too late. Livelihoods are lost, assets are depleted, and development gains reversed – forcing more people into chronic hunger, malnutrition and destitution across the continent.

African Governments know what they need to do and when they need to do it. ARC simply links existing early warning systems and national contingency plans to readily available funds. By shifting away from the old paradigm of treating the effects after a crisis occurs, Africa is moving towards effectively managing its risks. Actively managing risks is more economical, more efficient, and saves more lives and livelihoods. The aim of ARC is to catalyse a better risk management system for Africa and provide the capacity building support required to implement such a system.

How does the African Risk Capacity work?

ARC provides governments with access to immediate funds for early and planned responses to natural disasters. It brings together four critical elements: early warning, contingency planning, insurance and adaptation finance.

In order to participate in ARC, countries must undertake several processes, including signing a Memorandum of Understanding for in-country capacity building. This involves customisation of *Africa RiskView* software to define the risk profile for the country, preparing a contingency plan for ARC payouts, and determining risk transfer parameters.
When countries have satisfactorily completed this process, they will receive a Certificate of Good Standing from the ARC Agency Governing Board and which serves as the basis upon which a government can secure insurance coverage with ARC's financial affiliate, ARC Insurance Company Limited (ARC Ltd).

The pre-planning process is aimed at ensuring that potential ARC Ltd payouts are used quickly and effectively and that ARC funds reach the most vulnerable populations in an efficient and timely manner. For droughts, triggered payouts from ARC Ltd reach national treasuries within 2-4 weeks of the end of the growing season so that the first assistance can reach those who need it within 120 days.

120 days

ARC payouts arrive in the national treasury within 2 - 4 weeks, so that the first assistance starts to reach needy households within 120 days

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

ARC Insurance Company Limited

ARC Insurance Company Limited (ARC Ltd) is the financial affiliate of ARC Agency. It was established in 2013 to provide insurance to participating sovereigns. It is a mutual insurance company owned by its members (participating African governments and capital contributors DFID and KfW on behalf of BMZ , and incorporated for an interim period in Bermuda. The UK and German governments commited $200 million in risk capital.

In the context of ARC Ltd, risk pooling involves combining the risk of drought and, in the future, other extreme climate events occurring across several countries to take advantage of the natural diversity of weather systems across Africa. By doing this, the ARC Ltd pool then takes on the risk profile of the group rather than the risk profile of each individual country, combining the uncertainty of individual risks into a calculable risk for the group.

Since it is unlikely that droughts will occur in the same year in all parts of the continent, not every country participating in the pool will receive a payout in a given year. Because a continental risk pool's exposure to covariant drought risk would be significantly smaller than a given country's or region's exposure, the ARC Ltd pool is able to manage drought risk with fewer funds than if each country financially prepared for its own worst case drought scenario individually. This diversification benefit is further enhanced by ARC Ltd with the addition of new perils such as flood and tropical cyclones.

How does ARC Ltd work?

Members of the ARC risk pool receive a payout when the rainfall deviation is sufficiently severe such that the estimated response costs – estimated by Africa RiskView – cross a certain pre-defined threshold. When that threshold is crossed, qualifying risk pool members receive a payout within 2-4 weeks of the end of the rainfall season, thereby allowing them to begin early intervention programmes before vulnerable populations engage in negative coping actions.

The payout threshold is determined by the risk transfer parameters which are selected by each country. These parameters determine the actual amount of risk to be transferred to ARC Ltd, the frequency at which payouts might be triggered and, consequently, the cost that a Government will be required to pay to purchase the insurance coverage (premium).

The first ARC Ltd pool was launched in May 2014. ARC Ltd issued drought insurance policies totalling nearly $130 million in coverage to Kenya, Mauritania, Niger and Senegal. This was in return for a total premium cost of $17 million. Five additional countries joined the pool in May 2015, thereby increasing drought coverage to $192 million for the 2015-16 rainfall seasons.

Has ARC Ltd made any payouts?

In its first year of operation, three of the four countries that formed ARC's inaugural risk pool – Senegal, Mauritania and Niger – received a payout of over $26 million from ARC Ltd following a poor agricultural season as a result of a severe drought in the Sahel in 2014.

Senegal, Niger and Mauritania had paid a combined premium of $8 million and used the payout to mobilise early drought interventions based on pre-approved contingency plans. ARC Ltd approved payment of claims in January 2015 to the three Member States and by mid-February, procurement had already begun while the UN consolidated appeal was still being formulated.

AFRICAN RISK CAPACITY
Institutional Structure