



## Policy Framework

### Extreme Climate Facility (XCF)

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## Document Revisions

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### Document Revision History

This table provides a summary of the main changes per version.

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## Acronyms

<b>ARC</b>	African Risk Capacity
<b>APRM</b>	African Peer Review Mechanism
<b>AU</b>	African Union
<b>CoP</b>	ARC's Conference of Parties
<b>DREA</b>	AU Department for Rural Economy and Agriculture
<b>EU</b>	European Union
<b>IPCC</b>	Intergovernmental Panel on Climate Change
<b>XCF</b>	eXtreme Climate Facility
<b>UNFCCC</b>	United National Framework Convention on Climate Change

## 1. Scope

The eXtreme Climate Facility (XCF) focuses on climate change adaptation initiatives that address climate-related hazards resulting from acute (or rapid) or chronic (or slow-onset) events. The economic losses in a community are driven by single, or a combination of, water, temperature, wind, and solid-mass related natural phenomenon. Climate change adaptation refers to actions taken to increase a society's ability to respond to climate change. Based on European Union (EU) Technical Expert Group on Sustainable Finance<sup>1</sup>, adaptive activities do not lead to elevated climate risk or hamper adaptation elsewhere and consider green or nature-based solutions over grey solutions.

## 2. Background

Under Article 2 of the ARC Establishment Treaty, ARC Agency was established in 2012 as a Specialised Agency of the AU to help Member States of the African Union to improve their capacities to better plan, prepare and respond to Extreme Weather Events<sup>2</sup> and Natural Disasters<sup>3</sup>. Afterwards, ARC Insurance Ltd was set up to facilitate ex-ante risk response using insurance issued to African governments as the preferred risk transfer instrument. Its first drought risk pool was established in 2014, and the number of participating Member States continue to grow.

In March 2014, at the Seventh AU-ECA Joint Annual Meetings in Abuja, Nigeria (decision no. 927(XLVII)) ARC Agency was specifically requested to develop a proposal for a mechanism through which African states can access climate change adaptation financing given the impacts of increased climate volatility. There is overwhelming climate scientific evidence, including reports from Intergovernmental Panel on Climate Change (IPCC), that suggests that increases in greenhouse gas emissions is leading to rises in global temperature, and are also attributable to the increase in the observed frequency and severity of natural disasters. At this trend, potential future impacts of natural disasters are expected to be worse and will become increasingly costly for Member States to insure against weather-related risks in future.

According to a study <sup>4</sup>commissioned by African Development Bank in 2012, various research puts Africa's cost of climate adaptation in the region of US\$20-30bn per annum over the next 10 to 20 years. Despite the amount of climate adaptation funding African countries have attracted to date, there remains a significant investment gap for ARC Member States to build more resilient communities and to develop adaptive capacity to the impact of climate change. Delays in addressing climate financing

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<sup>1</sup> EU Technical Expert Group on Sustainable Finance. (2020). *Taxonomy: Final report of the Technical Expert Group on Sustainable Finance*. Brussels: European Commission. Retrieved from [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf)

<sup>2</sup> ARC's Establishment Treaty defines Extreme Weather Events as a weather phenomenon that is at the extreme of historical distribution.

<sup>3</sup> ARC's Establishment Treaty defines Natural Disaster as a sudden calamitous event caused by natural forces that results in serious disruptions of the functioning of a community or society causing widespread human, material, economic and/or environmental losses that exceed the ability of the affected community or society to cope using its own level of resources.

<sup>4</sup> African Development Bank (2012) *The cost of adaptation to climate change in Africa*. Retrieved from <https://www.vivideconomics.com/casestudy/the-cost-of-adaptation-to-climate-change-in-africa/>

solutions will further exacerbate the projected level of economic losses and financing gaps, while increasing the need to develop institutional capacity, climate infrastructure and other services.

As such, XCF leverages on ARC's existing infrastructure and future research developments to address the shortcomings and while ensuring they deliver value for money.

## 2.1 Document Purpose

There are various barriers to climate financing solutions that can narrow climate adaptation gaps in Africa. Some of the barriers include high cost of government borrowing, weak policies and structures to effectively promote and develop investable project pipelines and manage residual economic losses and uncertain damages emerging from changing future climate conditions.

This policy sets out a three-point agenda and corporate stewardship to support climate change adaptation goals and the development of financial solutions. The programme aims to:

- develop financial instruments to attract capital market investors,
- support national public policy agenda to promote best practices in climate adaptation planning, and,
- integrate climate science in the decision making.

### 2.1.1 Intended Audience

This policy is relevant to ARC, target beneficiaries in communities across its Member States, and external stakeholders that will participate to drive initiatives addressing climate adaptation interventions. Given ARC's role in African Union's Adaptation Strategy<sup>5</sup>, the programme aims to collaborate with actors and other initiatives in achieving the continental objectives for climate change adaptation.

## 3. Policy Framework

The framework encompasses clear policy objectives, underlying principles and other key practice codes to facilitate admissible solutions appropriate for various stakeholders. It also promotes assurance that the requirements for the implementing and operating the programme are adequately appraised and with no compromise.

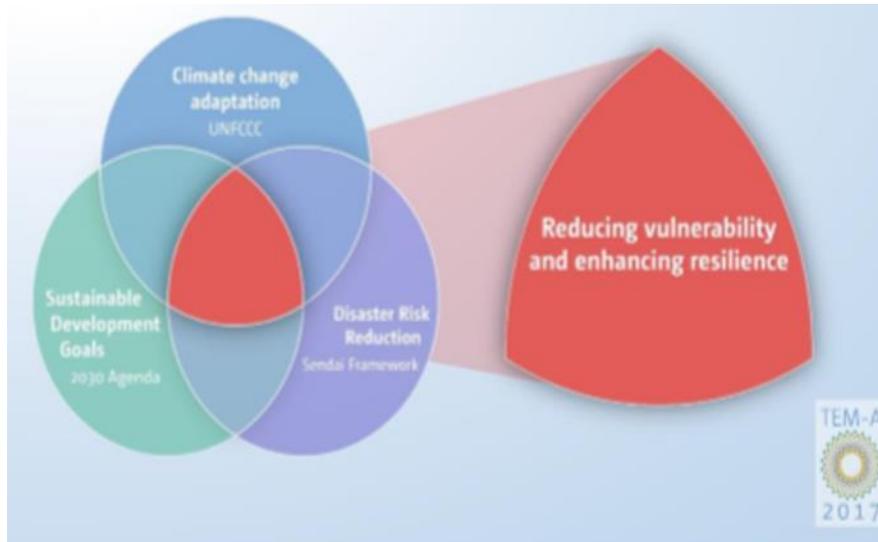
### 3.1 Policy Objectives

The core policy objective is to **reduce vulnerability and enhance resilience**. According to a Technical paper by UNFCCC Secretariat, integrating adaptation, sustainable development and disaster risk reduction can contribute to the achievement of this objective. Efforts to achieve Sustainable

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<sup>5</sup> Draft African Union Adaptation Strategy On Climate Change. (2014). Retrieved from [https://www.un.org/en/africa/osaa/pdf/au/cap\\_draft\\_aclimatestrategy\\_2015.pdf](https://www.un.org/en/africa/osaa/pdf/au/cap_draft_aclimatestrategy_2015.pdf)

Development Goals (SDGs) and implement the Sendai Framework while advancing adaptation initiatives are therefore of paramount importance.



Source: “*Opportunities and options for integrating climate change adaptation with the Sustainable Development Goals and the Sendai Framework for Disaster Risk Reduction 2015–2030*”, Technical Paper by UNFCCC Secretariat, 2017

Other policy objectives include:

- **Provide financing to vulnerable communities exposed to climate-related risks.** The nature, frequency and severity of climate hazards are uncertain, and future natural disasters may also render past initiatives inadequate with unplanned and immediate ramifications. A multiplicity of capital market solutions and international assistance is necessary to secure funding for vulnerable population to manage the effect of future climate risk.
- **Act as a catalyst to wider climate financing alternatives.** By default, national budgets are the primary funding sources, yet they are heavily limited due to other public expenditure demands. Additional opportunities to access cheaper national and international financing options eases the national burden and can be attractive financing extensions to the national budget for the communities.
- **Contribute to the global agenda for a more climate-resilient planet.** Proliferation of international and regional initiatives increase the global resilience deliberations but have limited local impact. Global best practices and transformative initiatives continue to evolve in tackling the impact of climate change. Through local knowledge sharing and community-led advocacy, resilience can be advanced and this ultimately ensures that global progress is achieved.
- **Support co-benefits in social re-engineering efforts and best practices.** The degree of climate change impact and the resultant social effects varies between societies and sectors. Without the necessary pro-active behaviour to advance best practice in a systematic approach, the impacts can further widen pre-existing imbalances that will require even more social re-engineering efforts with minimum adaptation benefits.

- **Adhere to environmental, social, and governance (ESG) best practices.** The increasing demand for transparency and operational confidence requires a high degree of standardisation and oversight. Internationally acceptable practices will promote an effective collaboration between international and national communities, and endorse credibility.
- **Support national public policy agendas to promote best practices in climate adaptation planning** Broadly, the limitation or lack of clear national climate policies that promotes support mechanism, financing structures and solutions inhibit the extent of meaningful adaptation planning and execution across a given country. As such, implementing effective adaptation plans and achieving sustainable development objectives requires the support of an enabling national climate policy.
- **Integrate climate science in decision-making** The ability to assess current and future climate risks is a critical element of an effective climate risk management. Ensuring tools are available and knowledge development will better inform the quality of solutions and their outcomes.

### 3.2 Underlying Principles

The principles underpinning the framework provides a uniform and consistent rationale that will support a national programme, which meets the following criteria:

- **African-led and African-owned** At national and local government levels, the priority should focus on building institutional capacity involving relevant national authorities and communities.
- **Value for money** The intervention should produce outcomes with material (positive) social impact for beneficiaries in target communities. A good governance structure and protocols must be in place to avoid negative social impacts.
- **Coherence i.e. with national, regional and global policies.** The extent of deviation between policies and its effect on activities should be minimal. Where a conflict is identified, application of best practice must prevail with clear rationale to the participating stakeholders to assist in comprehensively addressing interventions in a coherent and strategic manner.
- **Complementarity i.e. aligns with theory and practice of climate adaptation.** Capacity building is fundamental and encouraged using practical and effective knowledge media and platforms.
- **Inclusivity i.e. with other climate adaptation and DRR actors and initiatives.** Initiatives that are promoted should aim to avoid competition and conflicts between stakeholders and must avoid crowding out other actors and opportunities.
- **Integrity.** The implementation of interventions must avoid reputational issues and promote transparency with decisive improvements towards governance best practices.
- **Forward accountability i.e. contrary to just accountability that tends to be retrospective by nature.** Every decision on proposed interventions must consider the short-, medium- and long-term climate risks, and must demonstrate that such decisions improve the vulnerability profile of target beneficiaries over the life cycle of a given intervention.

### 3.3 XCF Services to Member States

ARC's annual risk pools provide Member States with an opportunity to transfer economic losses resulting from weather events. In order to further build adaptation and resilience to address current and emerging physical risks in a community over short-, medium- and long-term horizons, it is fundamental for Member States to include other capital market solutions in their national climate financing strategy. Adaptation financing instruments and solutions for loss and damages resulting from

future climate risks will aim to reduce the economic losses in a community exposed to a single, or a combination of, water, temperature, wind, and solid-mass related extreme events that are acute (or rapid) or chronic (or slow-onset).

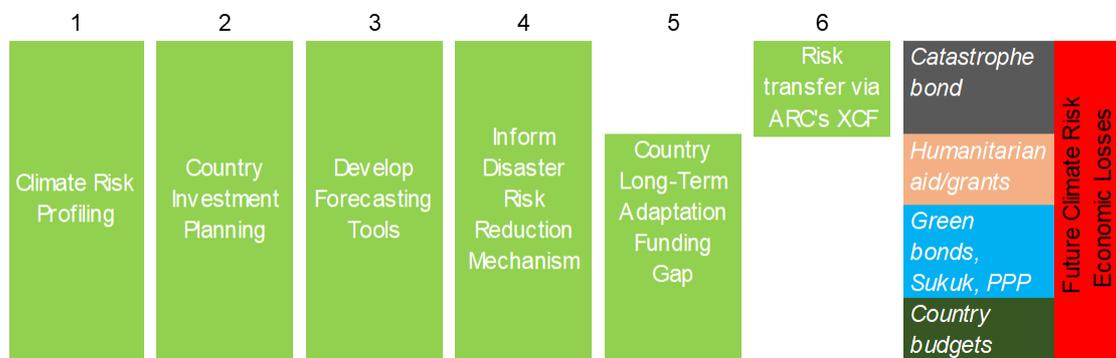
The XCF programme will provide integrated services that focuses on identifying sources of financing and developing financial instruments considering the need to:

- assess a community’s available resources relative to short-, medium-, and long-term needs to improve local vulnerability profiles for water-related, temperature-related, wind-related, solid-mass-related or a combination of extreme events; and,
- develop mechanisms to risk transfer emerging economic losses and damages due to the consequences of developing future climate risks.

However, developing financing solutions Member States for resilience and adaptation is incomplete without enhancing institutional development and capacity building that requires:

- profiling a community’s vulnerability to climate risks over short-, medium- and long-term horizons with views on acute and chronic hazards,
- supporting the development of investment plan for climate change adaptation,
- providing a platform and technology to track and analyse climate risk, and,
- encouraging, identifying and improving new and existing disaster risk reduction mechanism.

**Illustration: XCF integrated services to Member States**



**3.4 Implementation Mechanism**

ARC management will decide on the appropriate partners specifically in line with XCF’s strategic objectives as detailed in ARC’s medium-term strategic plan. In achieving the policy objectives and providing the above services to Member States, ARC will collaborate with a non-exhaustive list of external stakeholder groups that will include:

- African Union bodies, regional economic communities and national governments for advancing policy development, disaster risk reduction and climate change adaptation in accordance to the African Union Adaptation Strategy;
- Financial partners to support development of financial vehicle(s) and implementing financial instruments;

- Technical partners to advance technical knowledge on practices and tools to facilitate solutions; and,
- Public and private institutions, academic institutions and donor community to support other resources to develop initiatives and implement climate adaptation interventions.

### 3.5 Risk Appetite Statement

In general, financing every acceptable climate adaptation initiative introduces and exposes ARC and its stakeholders to varying degrees of risks. These are anticipated challenges. ARC will only accept risks that can be executed effectively and efficiently without any financial, operational or reputational consequences to ARC, engaged Member States, implementation partners and other stakeholders.

The programme's Risk Management Policy sets out the risk preferences and tolerances for various risk categories and types. The Group Risk Dashboard also ensures that key risk types are monitored and reported periodically to the ARC Group Board.

Climate adaptation interventions are location- and context-specific, and ARC and its implementing partners will therefore focus on the value of social impact attributable to each intervention, aligning interventions to ARC's strategic objectives, and minimising key strategic risks to the sustainability of the programme.

### 3.6 System of Governance

For ARC, the system of governance operates as a continental institution to support governance arrangements required to implement climate change adaptation initiatives in Member States. At the minimum, a national steering committee in Member States is required to oversee adaptation financing and other operational interactions between ARC, designated authorities and the target communities.

ARC's Establishment Treaty (2012) sets the foundation for the system of governance. The Conference of Parties (CoP) for ARC is the highest governing oversight body that determines the objectives and operations of the XCF. For example, the CoP will:

- adopt the programme's strategic plan, and annual Programmes of Work and budget,
- decide on the necessity of establishing or causing to be established, or dissolving or causing to be dissolved any ARC Agency Subsidiary or Affiliated Entity and whether such entities should be established under national law,
- appoint, and dismiss if necessary, the independent auditor,
- decide and prioritise activities of the Agency relating to extreme weather events and natural disasters affecting different parts of the continent, and,
- conduct annual review of XCF's performance against set policy objectives.

The ARC Group Board ensures that the stated functions in the Establishment Treaty and delegated activities from the CoP are achieved. This will include ensuring relevant sub-committees are instituted to advise on the delegated duties from the Board.

ARC Management oversees the day-to-day operations of the XCF programme.

## 4. Appendices

### Appendix 1: Reference or related ARC-specific documentation

1. Agreement for The Establishment Of The African Risk Capacity (ARC) Agency, 2012
2. Placeholder: Add details of amendment to ARC Treaty
3. Extreme Climate Facility: Cost Benefit Analysis; reported prepared by Vivid Economics for the African Risk Capacity (ARC), July 2020
4. Extreme Climate Facility: Standards and Guidelines; report prepared by Vivid Economics for the African Risk Capacity (ARC), July 2020