



# Risk Financing for Climate Adaptation and Resilience: Extreme Climate Facility (XCF)

**Briefing Paper on Pillar 1 of the R&D Programme: Defining access modalities and eligibility criteria for XCF**  
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## Acronyms

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AF	Adaptation Fund
ARC	African Risk Capacity
AU	African Union
CCA	Climate Change Adaptation
CDKN	Climate and Development Knowledge Network
CPI	Climate Policy Initiative
DFID	Department for International Development
DRR	Disaster Risk Reduction
ECI	Extreme Climate Index
FONERWA	National Climate and Environment Fund (Rwanda)
GCF	Green Climate Fund
GEF	Global Environment Facility
IPCC	Intergovernmental Panel on Climate Change
KfW	German Development Bank
M&E	Monitoring & Evaluation
MIE	Multilateral Implementing Entity
NAP	National Adaptation Plan
NIE	National Implementing Entity
OECD	Organisation for Economic Co-operation and Development
RIE	Regional Implementing Entity
SIDA	Swedish International Development Cooperation Agency
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
XCF	Extreme Climate Facility

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## Executive Summary

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Given Africa's extensive exposure and vulnerability to climate-related risks, there is an urgent need to scale-up efforts to adapt both to current inter-annual variability and projected future changes. To support these efforts, targeted investments and technological support across regions and sectors will be required, together with substantial fiscal outlays by governments and investments made by the private sector.

Since 2012, African Risk Capacity (ARC), a specialised agency of the African Union, has been providing financial tools and services to its African member states to enable them to improve their ability to manage their climate and weather-related risks. In an effort to help its member countries improving their resilience to climate change over the longer term, and in view of the significant funding gap in this area, ARC is designing a new sovereign risk financing mechanism for its Member States – the Extreme Climate Facility (XCF). XCF will be available for those countries already managing weather risk through ARC insurance products, provided they submit adaptation investment plans that meet certain standards and guidelines. Should pay-outs be triggered by an objective multi-hazard Extreme Climate Index, the monies from XCF should be used to support climate change adaptation (CCA) and disaster risk reduction (DRR) to increase national resilience to future weather shocks<sup>1</sup>. This increased resilience will help to ensure that ARC insurance premiums remain affordable and manageable, even in the face of climate change.

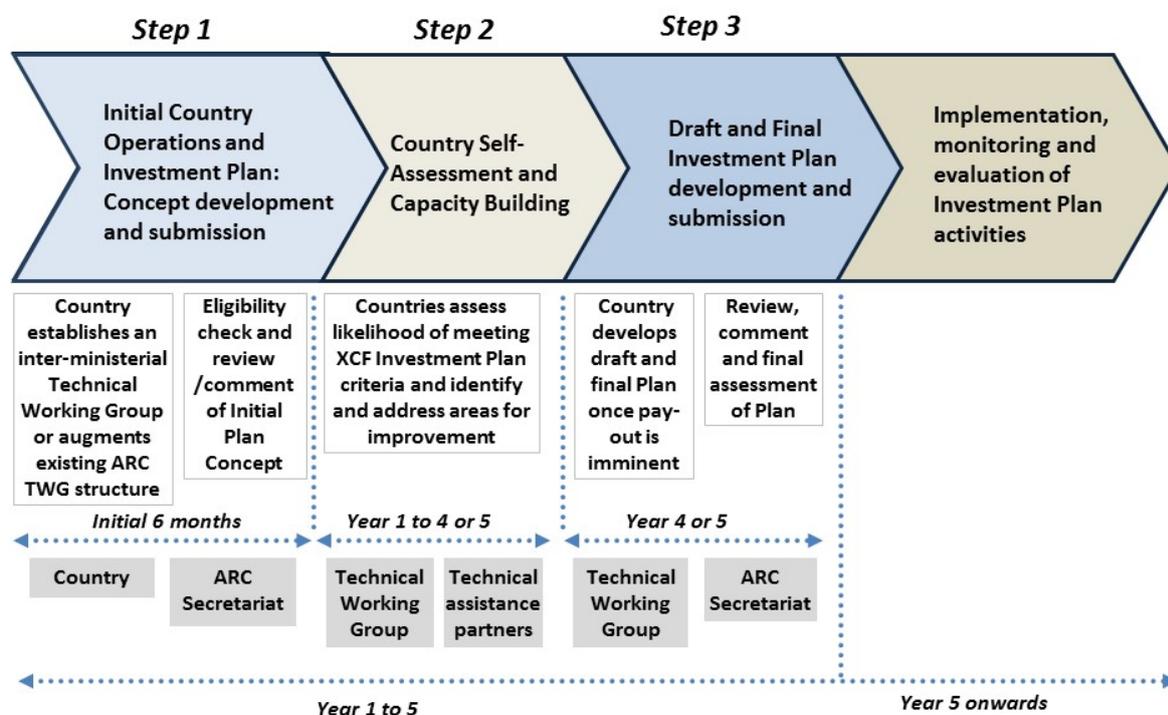
This paper provides recommendations on standards and guidelines that could be used by the XCF to assess the adaptation and disaster risk reduction investment plans (hereafter adaptation investment plans) to be submitted by the participating countries. Recognising that not all countries will be in a position to do this immediately, it also proposes a series of engagement steps – the three step process – for countries to meet the eligibility criteria to access XCF funding (Figure 1).

The recommended XCF adaptation investment plan criteria seek to find a balance between international good practice, as well as the realities on the ground. This balance between robust standards and practicable/realistic benchmarks aims to ensure that XCF is both accessible to countries in the near term, whilst simultaneously instilling confidence and mitigating reputational risk among the donors supporting the programme, and for the investors providing the capital and other ARC member states. In line with other direct access funds, such as the Adaptation Fund (AF) or the Green Climate Fund (GCF), the criteria were structured around three main domains: CCA/DRR activities to be funded (Table 1), project management capacities (Table 2), and financial governance (Table 2).

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<sup>1</sup> Hereafter the use of the term CCA incorporates DRR

**Figure 1: Proposed Three-Step Adaptation Investment Plan Development Process**



**Table 1: Proposed XCF evaluation criteria themes for CCA/DRR Activities**

CCA/DRR activities outlined in Investment Plan
<b>Addressing risks</b>
<ul style="list-style-type: none"> <li>Risks triggered by the Extreme Climate Index for example, or as measured by local climate monitoring and information systems</li> </ul>
<b>Enabling country-identified CCA and DRR priorities</b>
<ul style="list-style-type: none"> <li>Appropriate to country commitments to CCA and DRR</li> <li>In-line with CCA and DRR policies/strategies/national Investment Plans</li> <li>In-line with climate- and disaster-mainstreamed sector and/or ministry plans</li> <li>In-line with medium- to long-term development plans</li> </ul>
<b>Effectively enabling adaptation to identified risks</b>
<ul style="list-style-type: none"> <li>Reduce household vulnerability and/or build effective climate resilience</li> <li>Not duplicative or redundant of pre-existing external CCA/DRR activities</li> <li>Scale up of existing initiatives</li> <li>Complementary to the existing ARC Contingency Plans for insurance policies but forward-focused</li> <li>Improve communication of weather/climate information and/or Early Warning Systems</li> </ul>
<b>Demonstrating value for money and fund leverage</b>
<ul style="list-style-type: none"> <li>Cost efficient measures (value for money)</li> <li>Sustainability and replicability</li> <li>Potential for co-financing</li> </ul>

**Table 2: Proposed XCF evaluation criteria for the financial / project cycle management**

Financial management capacities of the channelling entity	Project cycle management capacities and implementation considerations
<b>Basic financial capacities</b> <ul style="list-style-type: none"> <li>▪ Financial and accounting system</li> <li>▪ Disbursement procedures</li> <li>▪ Funds transfer</li> </ul>	<b>Project cycle management capacities</b> <ul style="list-style-type: none"> <li>▪ Robust project management structure and implementation plan (oversight/management structure)</li> <li>▪ Clear procurement guidelines</li> <li>▪ Environmental and social safeguards</li> <li>▪ Gender equity</li> </ul>
<b>Financial accountability</b> <ul style="list-style-type: none"> <li>▪ Financial reporting and good standing with development financial partners</li> </ul>	<b>Monitoring and evaluation and reporting</b> <ul style="list-style-type: none"> <li>▪ Activity M&amp;E and reporting plan</li> <li>▪ Risk management framework</li> </ul>
<b>Risk management and financial control framework</b> <ul style="list-style-type: none"> <li>▪ Financial control and risk management</li> <li>▪ Fraud and financial management policies which are well communicated</li> <li>▪ Financial monitoring and evaluation</li> </ul>	<b>Project implementation considerations</b> <ul style="list-style-type: none"> <li>▪ Qualified staff</li> <li>▪ Clearly defined roles</li> <li>▪ Successful track record</li> <li>▪ Capacity to reach targeted beneficiaries</li> </ul>

A three-step engagement process is proposed for countries to access XCF funding (Figure 1). These steps have been designed in such a way as to allow countries to identify and, where necessary, build up their capacities and improve their approach to developing adaptation investment plans prior to an imminent XCF pay-out. They also allow anticipating gaps which may exist in-country and gain an overview early on as to which activities countries may intend to finance within the national structure of adaptation planning, and their possible funding amounts in the short-term and over-time. Each step is checklist-based and the process is neither intended to be arduous nor duplicative of in-country processes – but instead gives the opportunity to cross-reference and elaborate on them (where appropriate). The third-and most comprehensive-step need only be completed when indications are that a pay-out is imminent.

These recommendations are derived from an extensive desktop study outlining the current state-of-thinking on CCA and DRR, existing governance structures for key sources of climate finance, the current status of climate finance flows and barriers, and in-country financial management processes. A desk-based study was coupled with six in-country missions (Burkina Faso, Ethiopia, Kenya, Malawi, Rwanda and Zambia), to inform the range of contexts in which the XCF mechanism will operate and thus ensure the design of the eligibility criteria are both robust and realistic.

The paper first provides a short introduction to the XCF. It then presents the key findings from the desk study and the in-country missions, which inform the design of the suggested XCF adaptation investment plan criteria. The paper further provides key takeaways from the two-day workshop held in Addis Ababa in April 2016 where the XCF was presented to representatives of ARC Member States

and of the donor community to present the XCF. It concludes with the anticipated engagement process for countries to access XCF funding and proposed way-forward.

## **Introduction: the Extreme Climate Facility (XCF)**

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The estimated costs of adapting to climate change range from around \$70-100 billion per year by 2050<sup>2</sup>. Further, there is already a significant deficit, or adaptation gap, particularly in Sub-Saharan Africa. The United Nations Framework Convention on Climate Change (UNFCCC) outlines that developed countries, whose industrialisation has contributed to the augmented levels of greenhouse gases in the atmosphere, have a responsibility to support developing countries in their attempts at adaptation.

A number of international funds have been created to assist the transfer of funding from developed to developing countries, including the Adaptation Fund (AF) and Green Climate Fund (GCF) and a variety of bilateral structures, predominantly through the provision of grant support. Such funds have made inroads into the transfer of adaptation finance. However accessing international funds can be challenging, since few countries have so far been successfully accredited for direct access. Further, public finance alone will also be insufficient to address the needs of climate change adaptation (CCA) and disaster risk reduction (DRR)<sup>3</sup>. As such, there is growing momentum for greater private sector engagement, including by climate proofing their own operations and assets as well as supporting climate-resilient investments. Indeed the GCF has a private sector facility intended to catalyse private funding flows and unlock investments that address climate change. Green bonds have also grown from a concept to issuance values of \$50-70 billion in 2015, as well as insurance and insurance-linked securities that make resources available to respond to extreme events.

In line with these efforts, ARC is designing a new sovereign mechanism for its member states – the Extreme Climate Facility (XCF) – available for those countries that have joined the ARC insurance pool. This new mechanism is expected to be structured as a series of five year financing windows. A pay-out under XCF will be triggered if there is a deviation from long-term average climate conditions as defined by an objective Extreme Climate Index (ECI).<sup>4</sup> Owing to the uncertainty of climate futures, it may be that no pay-out will occur in a five year financing window. As such, the XCF is not structured to address short-term funding needs for adaptation but rather designed as a tool to help countries

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<sup>2</sup> OECD (2015) Climate finance in 2013-14 and the USD 100 billion goal, a report by the Organisation for Economic Co-operation and Development (OECD) in collaboration with Climate Policy Initiative (CPI), Paris, 61p; -Chambwera M., Heal, G., Dubeux, A., Hallegatte, S., Leclerc, L., Markandya, A., McCarl, B., Mechler, R. and Neumann, J. (2014) Economics of Adaptation. In: Climate Change 2014: Impacts, Adaptation, and Vulnerability. Part A: Global and Sectoral Aspects. Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change (Field, C.B., Barros, V.R., Dokken, D.J., Mach, K.J., Mastrandrea, M.D., Bilir, T.E., Chatterjee, M., Ebi, K.L., Estrada, Y.O., Genova, R.C., Girma, B., Kissel, E.S., Levy, A.N., MacCracken, S., Mastrandrea, P.R. and White, L.L. (eds.)) Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, pp. 945-977.

<sup>3</sup> Hereafter the use of the term CCA incorporates DRR

<sup>4</sup> For more information on XCF, please see <http://www.africanriskcapacity.org/xcf>

develop more comprehensive and robust climate change risk management portfolios, and to scale up and boost on-going adaptation efforts over the longer-term<sup>5</sup>.

The R&D phase is currently still ongoing to define the main characteristics of the new XCF mechanism. The R&D phase is separated into three work streams, where:

**- “Pillar 1” focuses on defining the access modalities and criteria for countries to be eligible:**

The recommendations made on access modalities and investment criteria for countries to be eligible to benefit from XCF are the subject of this paper and are summarised hereinafter.

**- “Pillar 2” focuses on developing the Extreme Climate Index and XCF triggering thresholds:**

While still ongoing, research on Pillar 2 has defined that the Extreme Climate Index will be based on meteorological data, specified by climatic region and designed to capture the severity and frequency of heat, drought, flood and other extreme weather events, such as cyclones, important to particular regions. A threshold will be set to identify extremes in the ECI time series for that region, and subsequent breaches of that threshold could indicate potential shifts in climate and a heightened risk of intense weather events occurring.

**- “Pillar 3” focuses on financial and legal structures and establishment options for the new facility:**

While many aspects of the structure still have to be defined, XCF will likely be structured as a series of five year financing windows. At the beginning of each financing window, the first of which is scheduled to start in 2017 at the earliest, the financial risk of XCF triggering pay-outs would be transferred to the international risk markets, through insurance policies, derivative contracts or catastrophe bonds. The triggered funds would be linked to deviations of the ECI during the five year period. If, at the end of the financing window, the ECI threshold has been breached, all of the eligible countries within the affected climatic region would receive an XCF pay-out to be used to fund pre-defined adaptation/DRR activities.

This paper focuses on “Pillar 1” – defining the ARC Member State access modalities and eligibility criteria for XCF.

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**“Pillar 1” of the R&D programme - defining the access modalities and eligibility criteria for XCF**

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ARC recognises that for the XCF to achieve its objective of enabling countries to improve their adaptation and risk management systems in light of a changing climate, and protect the effectiveness of ARC’s value proposition to its member states, there must be some mechanism in place to support countries to put the funds – if and when triggered – to good use. A similar principle underlies the ARC’s insurance products, which require that countries submit detailed contingency plans which clearly explain how a potential pay-out from the facility would be managed and spent. In the event that the country is to receive a pay-out on their ARC insurance policy, they must submit to

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<sup>5</sup> Vincent, K., Besson, S., Cull, T., Menzel, C. (2016) Sovereign insurance to incentivise the shift from disaster response to adaptation to climate change – African Risk Capacity’s Extreme Climate Facility. In preparation for Climate and Development

the ARC's Governing Board a Final Investment Plan, which, if and when approved, releases the pay-out to the member country. This enables a timely and effective response, allowing governments to cover their additional fiscal outlays in the wake of a disaster, while also providing households with the support they need to maintain their livelihoods and assets.

Despite their similarities, it is most likely that the pay-out from the XCF will be less frequent than the annual weather insurance products offered by ARC. The XCF should be seen as a complementary tool designed to support the existing efforts of countries to adapt to climate change. It will do this by requiring the submission of comprehensive and robust adaptation and disaster risk reduction investment plans (hereafter adaptation investment plans), highlighting how XCF funds will complement existing adaptation activities. The standards and guidelines against which countries' adaptation investment plans will be assessed to access the XCF should be adjusted to reflect the nature of the new mechanism. In order to develop such standards and guidelines, ARC has partnered with the Climate & Development Knowledge Network (CDKN) to commission a study in order to:

- Explore whether and to what extent investment-ready adaptation DRR plans exist in a group of ARC Member States, and enumerate adaptation and DRR "good practices" which can form the basis for the standards and guidelines;
- Determine how countries absorb international climate finance, and consider which fiduciary standards should be fulfilled to receive funds under "direct access modalities";
- Offer recommendations regarding how countries can best and most easily access XCF funds to maximise its potential for resilience and adaptation building.

CDKN has contracted the Frankfurt School-UNEP Centre for Climate & Sustainable Energy Finance and Kulima Integrated Development Solutions to undertake this research.

Based on a review of the literature and face-to-face interviews in six countries (namely Burkina Faso, Ethiopia, Kenya, Malawi, Rwanda and Zambia), Frankfurt School and Kulima have synthesised their findings into suggested standards and guidelines for XCF to use in assessing adaptation investment plans received from prospective members, as well as a three-step process for countries to utilise, ensuring they can successfully access funding.<sup>6</sup> These proposed standards have been designed around the principles of simplicity, flexibility, and complementarity with other international climate finance mechanisms. The consultant team has also suggested technical assistance and implementation partners to address any gaps between the status quo in countries and the proposed standards to be adopted by XCF.

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<sup>6</sup> These are summarized in a report: CDKN (2016), Climate risk financing for Africa – Identifying best practice and criteria for climate change adaptation XCF Country engagement process and Investment Plan Criteria Report

## **Current debates in adaptation/disaster risk reduction and principles for “good practices”**

Adaptation encompasses an enormous range of measures and actions, the nature of which varies considerably according to geographic location, climate hazard(s) faced, local and national development and sectoral contexts, the nature of available information about climate hazards and associated risks, and the timescale of priority.<sup>7</sup> A significant challenge exists in that the success (or otherwise) of adaptation can only truly be recognised when exposure to that recognised hazard has taken place and a (long-lasting) negative impact has not been felt. No universal metrics for adaptation exist, which poses a challenge for the (donor) organisations that are keen to develop indicators and M&E frameworks for their adaptation projects.<sup>8</sup> In fact, despite the massive number of projects claiming to enable adaptation, scientists have highlighted that there is a noticeable absence of evidence on how adaptation is occurring, particularly in the developing world.<sup>9</sup>

Amongst these conceptual and practical challenges, there are some accepted “good practices” and principles that ARC can use to inform the formation of XCF adaptation investment plans. Taking a risk management approach addresses the challenges of selecting and monitoring specific adaptation interventions and instead requires evaluation of the mechanisms by which those adaptation interventions can reduce risk, with multiple complementary mechanisms required to manage risk across a range of time frames and possible medium and longer term scenarios. It also enables flexibility in respect to the evolving nature of a country’s climate risk profile, taking into account that, in addition to adaptation to current risks, there will be a need to enable adaptation to future risks which will likely differ in nature (e.g. magnitude and frequency). Ensuring that adaptation is integrated into development (i.e. climate-resilient development) is also important, since climate risks will affect all aspects of society. Finally, current and future adaptation needs mean that there is a need for both “regular” development activities that also reduce vulnerability to a range of climate hazards and risks as well as highly-targeted adaptation measures designed to address specific, identifiable, and quantifiable current and future climate hazards.

While there is clearly a key role for the national level in adaptation, the integration across scales of governance is important, particularly since adaptation activities are often implemented at the local level. Ensuring effective capacity and communication at the local level also affords the opportunity for climate change adaptation to be better coordinated with DRR (often not the case as the two

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<sup>7</sup> Brooks, N.J.P., Joubert, A., and Vincent, K., with Byrne, R., and Ockwell, D. (2011), *Climate Change and Africa. An Overview for African Development Bank Senior Management*. Prepared on behalf of the African Development Bank by International Development UEA, University of East Anglia, 48p.

<sup>8</sup> Dinshaw, A. et al. (2014), “Monitoring and Evaluation of Climate Change Adaptation: Methodological Approaches”, OECD Environment Working Papers, No. 74, OECD Publishing.

<http://dx.doi.org/10.1787/5jxrclrOntjd-en>; Brooks, N et al. (2014), *An operational framework for Tracking Adaptation and Measuring Development (TAMD)*, IIED, London, and other publications at

[www.iied.org/tracking-adaptation-measuring-development](http://www.iied.org/tracking-adaptation-measuring-development); Bours, D., McGinn, C. and Pringle, P. (2013), *Monitoring & evaluation for climate change adaptation: A synthesis of tools, frameworks and approaches*. SEA Change CoP, Phnom Penh and UKCIP, Oxford.

<sup>9</sup> Berrang-Ford, L., Ford, J. and Paterson, J. (2011), *Are we adapting to climate change?* *Global Environmental Change* 21:25–33.

issues are typically spearheaded by different ministries). Ensuring appropriate levels of institutional and technical capacity to implement intended activities, as well as a considered approach to Monitoring and Evaluation (M&E) are also key principles for the adaptation investment plans. Linking these principles with the stage of country development of National Adaptation Plans (NAPs) and other policies/strategies is therefore critical.

### **Implications for recommended adaptation investment plan criteria for the XCF**

Good practice in adaptation and DRR planning will form the cornerstone of the XCF evaluation criteria and investment guidelines.

A risk management approach is widely accepted, and endorsed by the Intergovernmental Panel on Climate Change (IPCC), as the most appropriate way of proactively addressing adaptation and DRR. Since adaptation is so context-specific, the interventions themselves will not be as important as the inclusion of a mechanism for assessing to which level the proposed actions reduce risk. Adaptation investment plans should rather be based on a number of sound principles of adaptation and risk reduction.

- Plans should balance reducing the existing adaptation deficit with mainstreaming climate change across all sectors and levels while aligning with national priorities.
- Low or no regrets (win-win) interventions should be included in the plans, meaning that their benefits will accrue regardless of the climate future and enhance future flexibility and scalability for whatever climate scenarios come to pass.
- Plans should include a combination of hard (i.e. tangible) and soft (i.e. knowledge-based) adaptation options, as well as interventions directed at different administrative levels.

In the absence of universal metrics, the comprehensiveness and appropriateness of adaptation planning will hinge on an assessment of the institutional climate risk management mechanisms and their application in development planning.

- Plans should include a mechanism to assess change in general climate risk levels for sectors and areas (which is easier to determine than the success of adaptation), and monitor change in that risk (whether through a reduction in the likelihood of adverse effects, or an expansion of the range of toleration for risks). This is likely to take the form of a baseline vulnerability assessment against which progress is monitored using appropriately-selected indicators that will be included in the M&E framework.
- Plans should incorporate principles that are widely-accepted criteria for evaluating potential expenditure. This includes that the intended activities are feasible (i.e. can realistically be accomplished), effective (i.e. can produce the intended change) and equitable (i.e. have been designed to be socially inclusive).

Effective adaptation and DRR hinges on a robust understanding of emerging climate risks, including incremental changes in temperature/precipitation as well as extreme events, the latter being the

one targeted by the XCF. While the availability and quality of climate information is improving, few countries consider it in their planning.

- Plans should include active consideration of climate services, including a mechanism for monitoring and making modifications if required, based on the availability of new and more robust information. The fundamental structure of the adaptation investment plans is unlikely to change dramatically. If there is already high confidence in a drying trend, for example, it is highly unlikely that future models will all-of-a-sudden project a wetting trend. However, increasing resolution/detail on, for example, the frequency and magnitude of extreme events may mean that the specifics of an activity outlined within the plan may change. It may be the case, for example, that an adaptation plan includes ecosystem-based adaptation, such as tree planting, in a degraded watershed that is prone to flooding. The future generation of additional information regarding flood risk may allow fine-tuning of this particular activity within the plan – for example in defining the locations within that watershed where activities should be prioritized. In practice this means that the adaptation investment plans should be explicit as to what climate information is required to inform the design and implementation of interventions, and from whom this will be obtained (e.g. national meteorological/hydrological agency or an international source).

To ensure compliance, the M&E plan for specific interventions within the investment plan, if implemented, should include relevant indicators and a system to ensure that relevant climate information is being monitored and has been included. For the above example of ecosystem-based adaptation in a flood-prone degraded watershed an appropriate annual indicator to highlight consideration of new climate information might be that the meteorological service has been consulted for the seasonal forecast. Consider a situation where XCF has triggered and this intervention is being implemented by a country. During any year of the tree-planting intervention it may be that the seasonal forecast predicts a drier than average rainfall season. Ignoring this knowledge, and continuing to plant tree seedlings as initially planned, may lead to greater failure rates because lower than average rainfall may affect growth rates. This would be a waste of resources. Instead there should be flexibility in the management of the intervention to modify particular activities as appropriate to the conditions, for example annual review of the specific nature of planned activities within the broader length of the intervention. It may be, for example, that fewer new tree seedlings should be planted in a season that is predicted to be drier than average, because the elevated risk of them not surviving in drier conditions. Evidence of such proactive management and effective use of climate information would be part of the M&E framework for the activity to ensure maximum effectiveness and efficiency.

By way of overview, Table 1 lists the areas that are included in the proposed evaluation criteria for CCA/DRR activities.

**Table 1: Proposed XCF evaluation criteria themes for CCA/DRR Activities**

CCA/DRR Activities outlined in Investment Plan
<p><b>Addressing risks</b></p> <ul style="list-style-type: none"> <li>▪ Risks triggered by the Extreme Climate Index for example, or as measured by local climate monitoring and information systems</li> </ul>
<p><b>Enabling country-identified CCA and DRR priorities</b></p> <ul style="list-style-type: none"> <li>▪ Appropriate to country commitments to CCA and DRR</li> <li>▪ In-line with CCA and DRR policies/strategies/national Investment Plans</li> <li>▪ In-line with climate- and disaster-mainstreamed sector and/or ministry plans</li> <li>▪ In-line with medium- to long-term development plans</li> </ul>
<p><b>Effectively enabling adaptation to identified risks</b></p> <ul style="list-style-type: none"> <li>▪ Reduce household vulnerability and/or build effective climate resilience</li> <li>▪ Not duplicative or redundant of pre-existing external CCA/DRR activities</li> <li>▪ Scale up of existing initiatives</li> <li>▪ Complementary to the existing ARC Contingency Plans for insurance policies but forward-focused</li> <li>▪ Improve communication of weather/climate information and/or Early Warning Systems</li> </ul>
<p><b>Demonstrating value for money and fund leverage</b></p> <ul style="list-style-type: none"> <li>▪ Cost efficient measures (value for money)</li> <li>▪ Sustainability and replicability</li> <li>▪ Potential for co-financing</li> </ul>

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### **Climate finance readiness and absorptive capacity**

As well as having the technical capacity to implement effective adaptation, it is critical that countries are in an appropriate state of “readiness” to access and deploy XCF funds to the intended beneficiaries. To that end, they will need to have developed sufficient absorptive capacity for the management and effective spending of the pay-out should it arrive. In general, countries should demonstrate robust financial integrity, effectiveness, and accountability when accessing and allocating funding, which are based on transparent rules and procedures.<sup>10</sup> They should also have strong project management and oversight capacities to ensure that XCF funds are used as efficiently and effectively as possible.

There are more than 60 different international funds available for developing countries through bilateral, multilateral, and private sources,<sup>11</sup> meaning that there are precedents that can be considered for developing readiness standards (i.e. the capacity to “plan for, access, deliver, and

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<sup>10</sup> Adaptation Fund Board (2010), Report of the Third Meeting of the Accreditation Panel, AF Board 11th Meeting, Bonn, September 16-17 2010, AFB/B.11/4 / The Adaptation Fund, 2009, Report on Fiduciary Standards for Implementing Entities, Adaptation Fund Board, Sixth Meeting.

<sup>11</sup> Climate Finance Options, (2013), World Bank, UNDP, [climatefinanceoptions.org](http://climatefinanceoptions.org).

monitor and report on climate finance, both international and domestic, in ways that are catalytic and fully integrated with national development priorities and achievement of the MDGs.”)<sup>12</sup>

The only access modality available which truly aligns with ARC’s philosophy of support to countries is direct access, currently used by the Global Environment Facility (GEF), the AF, and more recently the GCF. This typically requires that countries select a National/Regional Implementing Entity (NIE/RIE) to apply for accreditation to be able to channel funds to the ultimate beneficiaries, as well as having executing entities which implement activities on-the-ground, and a national governing body ensuring that activities are in line with the country’s national adaptation and DRR strategy and plans. Alternatively, countries can work with a Multilateral Implementing Entity (MIE), which serves as a trustee/fund manager and is responsible for all financial management of funding channelled to the country.

Under direct access, fiduciary responsibility and programme monitoring responsibilities are transferred to national government/institution. Therefore they must be able to design adaptation investment plans at the policy level, execute projects at the national, regional and local levels,<sup>13</sup> and have the capacities to manage and be accountable for resource allocations and performance, all of which are important not only to ensure efficacy of pay-outs, but also to manage donors’ reputational and fiduciary risks. One indicator of readiness could also be countries’ past performance in handling ARC insurance pay-outs.

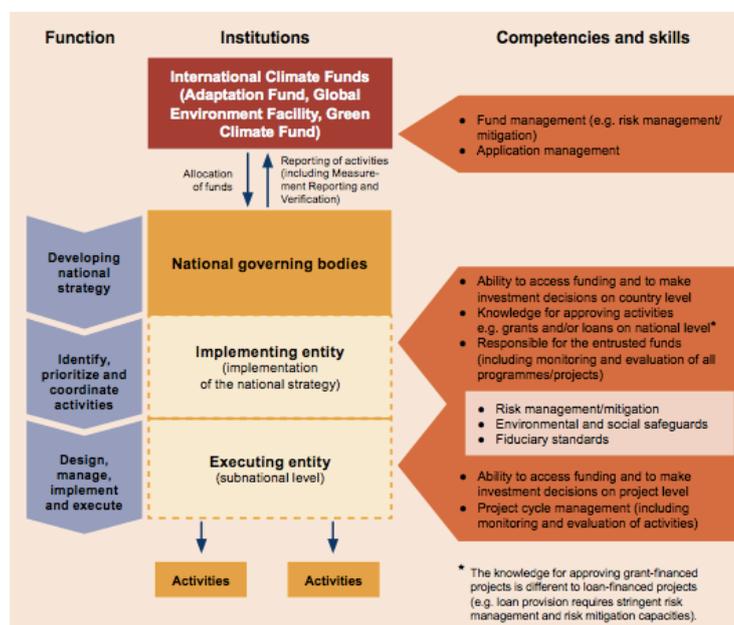
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<sup>12</sup> Vanderweerd et al. (2012), *Readiness for Climate Finance: A framework for understanding what it means to be ready to use climate finance*. New York: United Nations Development Program.

<sup>13</sup> Frankfurt School of Finance & Management - UNEP Collaborating Centre for Climate & Sustainable Energy Finance (2013), “Direct access to international climate finance and associated fiduciary standards”

Figure 1 shows the framework for direct access and requisite competencies and skills typically needed. The GEF and AF already offer direct access; GCF approved their first funding for projects and programmes in the first week of November 2015 for an amount of \$168m of which \$40m will be channelled through RIEs and NIEs with direct access modalities.

**Figure 1: Framework and competencies for direct access<sup>14</sup>**



Disbursements from these funds should provide lessons learned from the process for ARC.

### Implications for recommended adaptation investment plan criteria for the XCF

It is envisaged that XCF shall operate on a longer time horizon with eventually larger potential funding tranches than ARC’s annual weather insurance products, the requirements for adaptation investment plans and the management, oversight, and monitoring of pay-outs should be more stringent, in the longer run at least. Additionally, ARC may find value in setting higher standards to manage reputational risk and thereby ensure the sustainability of the facility. However, these requirements must be carefully balanced against placing excessive burdens on ARC’s Member States and the fact that XCF may not trigger pay outs in the near future.

Building upon the relevant good practice examples and lessons learned from other direct access funding sources (e.g. the AF, the GCF and, to some extent, the GEF), as well as in-country visits, the criteria developed for countries to prove climate finance readiness to access the XCF are focused on two fields:

- Financial management capacities of the channelling entity
- Project cycle management capacities and implementation considerations

<sup>14</sup> CDKN adaptation from Frankfurt School of Finance & Management - UNEP Collaborating Centre for Climate & Sustainable Energy Finance (2013), “Direct access to international climate finance and associated fiduciary standards”; [http://cdkn.org/2013/06/report-enhancing-direct-access-to-the-green-climate-fund/?loclang=en\\_gb](http://cdkn.org/2013/06/report-enhancing-direct-access-to-the-green-climate-fund/?loclang=en_gb), accessed in June 2016

By way of overview, Table 2 lists the areas that are included in the proposed evaluation criteria relative to these fields, not all of which will be relevant for each intervention:

**Table 2: Proposed XCF evaluation criteria for the financial / project cycle management**

Financial management capacities of the channelling entity	Project cycle management capacities and implementation considerations
<b>Basic financial capacities</b> <ul style="list-style-type: none"> <li>▪ Financial and accounting system</li> <li>▪ Disbursement procedures</li> <li>▪ Funds transfer</li> </ul>	<b>Project cycle management capacities</b> <ul style="list-style-type: none"> <li>▪ Robust project management structure and implementation plan (oversight/management structure)</li> <li>▪ Clear procurement guidelines</li> <li>▪ Environmental and social safeguards</li> <li>▪ Gender equity</li> </ul>
<b>Financial accountability</b> <ul style="list-style-type: none"> <li>▪ Financial reporting and good standing with development financial partners, including ARC</li> </ul>	<b>Monitoring and evaluation and reporting</b> <ul style="list-style-type: none"> <li>▪ Activity M&amp;E and reporting plan</li> <li>▪ Risk management framework</li> </ul>
<b>Risk management and financial control framework</b> <ul style="list-style-type: none"> <li>▪ Financial control and risk management</li> <li>▪ Fraud and financial management policies which are well communicated</li> <li>▪ Financial monitoring and evaluation</li> </ul>	<b>Project implementation considerations</b> <ul style="list-style-type: none"> <li>▪ Qualified staff</li> <li>▪ Clearly defined roles</li> <li>▪ Successful track record</li> <li>▪ Capacity to reach targeted beneficiaries</li> </ul>

Some relevant components of the international climate funds (mainly AF and GCF) were used as a model for the XCF's own conditional investment plan standards, whereby XCF criteria for eligibility do not match the requirements of the AF/GCF accreditation in every aspect. Consistency with the AF and GCF direct access accreditation criteria avoids unnecessary duplication and reduces the need for countries to show evidence of having met further requirements.

### Comparison of the XCF criteria with the AF/GCF criteria

There are similarities with the AF/GCF in the criteria chosen to demonstrate that sufficient financial management capacities and project cycle management capacities exist in the countries. However, overall the XCF access requirements are less burdensome whilst still being robust:

- most criteria require minimum proofs of evidence (project or financial document for the past and current years while the AF/GCF mostly require to collect documents *for the last 3 to 5 years*);
- some criteria of the AF/GCF have been left out, as examples:
  - Within the financial control framework section: well-defined code of ethics; fight against fraud policy; whistle blower protection; anti-money laundering and anti-terrorism financing policies are required as by the GCF/AF. However; *evidence of cases of fraud and evidence of an investigation function within the institution* were left out.

- Within the section on project cycle management capacities: procurement policy and guidelines procedures for overseeing the procurement function are required while *evidence of procurement and procurement complaints* were not required

It is overall recommended that harmonisation with the AF/GCF criteria be emphasised where possible, potentially to a greater extent in the medium rather than short term, as additional requirements can be introduced as volumes of international climate finance potentially increase in the future.

### Country case studies

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In addition to the theoretical overview, the authors reviewed the status of adaptation planning and financial and project absorption capacity in seven countries (Burkina Faso, Ethiopia, Kenya, Malawi, Rwanda, Senegal, and Zambia)<sup>15</sup> both remotely and through interviews with experts and officials in country. The purpose was to contrast theoretical good practice with reality in different contexts in order to inform the development of the adaptation investment plan criteria and ensure that they are both robust but achievable by ARC Member States. The information collected included climate risks, macroeconomic conditions and poverty reduction strategies, adaptation planning and governance structures, stakeholder mapping on adaptation finance and existing adaptation/DRR projects, and capacity needs assessment. They additionally provided information on climate finance governance, access to international funds, and public financial management systems.

A review of the status of adaptation/DRR planning in countries revealed significant contextual variation. Climate change and its importance in adaptation/DRR features implicitly in the medium-term development plans of some countries, whilst in others it is explicit. There are also variations in the extent to which the countries have specific climate change and DRR policies in place. Kenya, Malawi, Senegal and Zambia all have climate change policies/strategies/action plans in various stages of development. Rwanda and Ethiopia address adaptation in the form of climate resilience in their respective green growth strategies while Burkina Faso is advanced in developing its NAP as mandated by the UNFCCC.

Despite their similarities in aims, climate change/adaptation and DRR are typically dealt with by different policies and ministries. Burkina Faso, Ethiopia, Kenya, Malawi, and Rwanda have clear DRR policies and/or strategies. Zambia has a Disaster Management Act. Senegal is the only country that does not have a DRR policy or plan, instead incorporating it in its long-term development plan.

Likewise in terms of (climate) financial management structures, the case study countries exhibit differing institutional frameworks. In terms of direct access, four of the seven countries (Ethiopia, Kenya, Rwanda, and Senegal) have managed to accredit an NIE with the AF and to the GCF as of June 2016. In some countries, clear financing structures are in place for receiving climate finance and

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<sup>15</sup> It was intended to undertake seven country visits. However, for reasons beyond the control of the authors, Senegal could not be visited. Senegal data is from desktop research only, and has not been validated in-country.

channelling it towards adaptation, e.g. the Fund for Environment and Climate Change in Rwanda, FONERWA), however questions of scalability remain. The status of public financial management also differs from country to country.

### **Flexible approach offered by the XCF to ease countries' access**

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To enable the XCF to reach its intended scale and accommodate the varied capacities and skill levels across Africa, the XCF could consider a flexible approach whereby countries would have the possibility to gradually meet the XCF requirements and shall receive technical assistance to help them close the gaps identified in their adaptation investment plans. Since the fiduciary standards are so stringent for the GCF and AF, it is recommended that institutions already accredited by them are allowed a fast-track accreditation under the XCF – though this should not exclude countries lacking an NIE from joining the facility as well.

For countries where the proposed implementing institutions meet eligibility criteria, but do not have a track record of managing adaptation/DRR projects or overseeing funding, the XCF may allow the country to be eligible for funding if it agrees a more frequent reporting structure post-payout for the initial two years, for example.

Alternatively, the XCF may allow smaller and more frequent funding tranches to be released, rather than one large payout, which would be subject to review after two years, with additional allocated funding tranches being transferred thereafter.<sup>16</sup> This flexibility is also used by funds such as the GCF and the AF.

As frequently seen with the AF and GCF, it is anticipated that many African governments that would like to participate in the XCF will have gaps in their capacity, and may need to work with technical assistance partners to prepare their application and investment plan to the XCF to potentially receive funds, including interim solutions such as the ones described above where countries would partially meet the requirements in a first step and be entitled for smaller and more frequent funding tranches of a payout, should one be triggered.

In the short term, as a last resort countries that are unable to demonstrate their ability to manage funds could nominate an administrative agent/interim trustee to receive and manage XCF funds. This type of arrangement is utilised by several national climate finance institutions such as the Indonesian Climate Change Trust Fund, or the Mali Climate Fund. In the past, agencies such as the United Nations Development Programme (UNDP) have taken this role, though there are many reputable African institutions (e.g. regional or national development banks) that could take on this function.

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<sup>16</sup> GCF, (2014), Guidelines for the Operationalisation of the Fit-for-purpose Accreditation Approach, GCF/B.08/02, [http://www.gcfund.org/fileadmin/00\\_customer/documents/MOB201410-8th/GCF\\_B.08\\_02\\_Fit\\_for\\_Purpose\\_Accreditation\\_fin\\_20141005.pdf](http://www.gcfund.org/fileadmin/00_customer/documents/MOB201410-8th/GCF_B.08_02_Fit_for_Purpose_Accreditation_fin_20141005.pdf)

## **XCF investment guidebook for countries**

At times countries do not feel properly guided or informed of the requirements to fulfil fiduciary standards for the GCF and AF, they may therefore not deliver what is expected. Further, a large amount of supporting documentation is required; many potential NIEs were surprised by the amount of formalised processes that were required in addition to the “standard” documentation.

- It could be recommended that XCF develops an online toolkit, including a detailed manual with case studies and examples of documents to be submitted, as well as a step-by-step online guide available in all AU languages. Many countries reported that this tool was very helpful and improved the quality of subsequent applications.<sup>17</sup>
- It is recommended to clearly state the type of documentation required and provide at least a few examples, as titles of documentation vary from country to country and region to region.

## **Recommended country engagement process**

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Drawing on lessons learned from countries attempting direct access accreditation, it is recommended that XCF use three steps for countries to access XCF funding, in which countries first submit an Initial Country Operation and Investment Plan to allow ARC to provide feedback and conduct an “eligibility check,” followed by countries using a pre-defined self-assessment tool to get familiar with the XCF criteria and define gaps, and finally submitting the adaptation investment plans once a pay-out is imminent. Because XCF payout would carry with them the same risks for financial accountability and programme oversight as other direct access funding sources, the criteria aim to balance simplicity with a level of fiduciary management suitable for the amount of funding each country could potentially receive, bearing in mind that the pay-outs are uncertain. These steps allow ARC to anticipate gaps that may exist in-country and gain an overview early on as to which activities countries may intend to finance in case that a pay-out triggers, and their possible funding amounts.

To formalise this approach, the steps are reviewed here in greater detail. This process would involve the following:

**Step 1:** Using a predefined template, countries submit an initial country operations and investment plan “concept”. This will allow the ARC to check for XCF eligibility and also gain insights into the potential investment plan and possible associated costs; as well as to make any comments. Countries passing this check would be eligible to be part of and to potentially benefit from the upcoming XCF financing window.

**Step 2:** Using the self-assessment guide, that explains in more detail what they will need to provide, countries gain an overview of the criteria used to assess adaptation investment plans. These criteria can be useful to inform potential gaps and areas for improvement on the “concept” plan initially developed, and carry out capacity building with technical assistance partners that could be identified

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<sup>17</sup> Bugler, W., and Rivard, B., (2012), Inside Story: Direct Access to the Adaptation Fund: Lessons from Accrediting NIEs in Jamaica and Senegal, CDKN. Available at <http://cdkn.org/resource/cdkn-inside-story-direct-access-to-the-adaptation-fund-lessons-from-accrediting-nies-in-jamaica-and-senegal/>

by the countries (potentially with ARC support) prior to submission of the draft and final investment plan.

**Step 3:** Once a pay-out is imminent,<sup>18</sup> countries submit a comprehensive draft and final investment plan. ARC uses the investment plan criteria and the accompanying assessment tool for assessing the adaptation investment plans. A successful assessment would make a country eligible to receive funds from the XCF.

Figure 2 attempts to convey the indicative sequencing and tasks associated with each step. The timing of each step is a decision for the ARC Agency and its Member States to take. Note that a five year period was used to describe the process to match the five year financing windows underlying the XCF. It may be that some countries are in a position to very rapidly and successfully complete steps 1 and 2. However, for the majority of countries varying efforts will likely need to be placed into meeting eligibility criteria. Countries thus have the option to take advantage of this timeframe to identify and close identified gaps in their adaptation investment plans. However, the decision is up to the countries whether they will fully or partially use this timeframe to work on their investment plans, taking for example into account their national climate change priorities, their needs for capacity building in this area, and bearing in mind that pay-outs may not occur. It is recommended that countries develop their draft and final investment plans only when a pay-out is imminent.

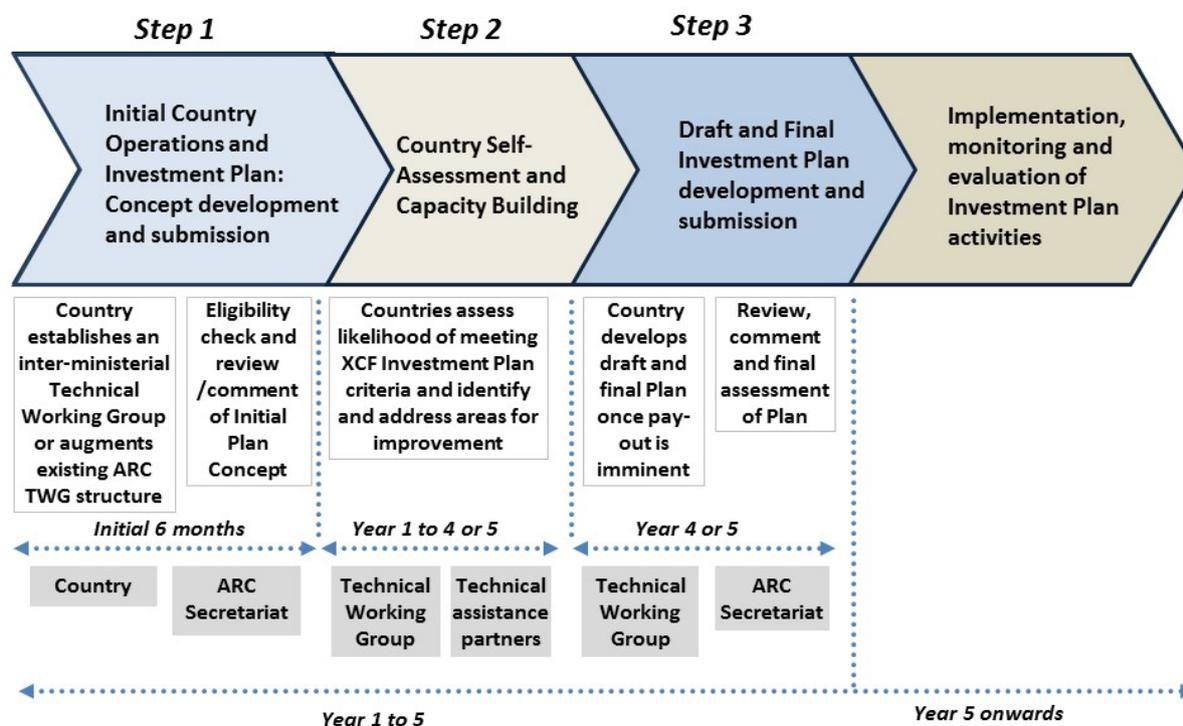
If the ECI would breach the threshold before the conclusion of the five-year period, funds could be released early to participating countries that have met the adaptation and disaster risk reduction investment plan criteria.<sup>19</sup>

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<sup>18</sup> The definition of “imminent” will need to be developed further by ARC based on the nature of the ECI and XCF financial structure.

<sup>19</sup> Ibid.

**Figure 2: Proposed Three-Step Adaptation Investment Plan Development Process**



### Initial feedback from member countries and the donor community on Pillar 1

The criteria and the engagement process outlined above were presented at the occasion of a two-day workshop held in Addis Ababa in April 2016 to representatives of ten ARC members countries (Chad, The Gambia, Kenya, Madagascar, Mali, Malawi, Mauritania, Niger, Senegal, and Zimbabwe) and of the donor community (including CDKN, the Rockefeller Foundation, DFID, KfW, SIDA and Global Affairs Canada). Useful recommendations were made by countries and donors representatives for the implementation phase of the XCF:

- While ARC member states welcomed the complementarity of the XCF investment criteria with activities undertaken in countries to access international climate finance, all representatives recognized the needs for technical assistance in several areas which were listed as part of the evaluation criteria for adaptation investment plans (i.e. fiduciary standards at the institutional level, project management abilities, as well as DRR/Adaptation activities). It should be determined more precisely how the technical assistance is expected to work as it will definitely be used by most countries.
- Strong political will and national commitment will be key to the success of the XCF as well as sufficient marketing and promotion of the facility – outlining the fact that it won't require additional contributions from the countries other than their annual ARC insurance premium payments.

- Some concerns were raised on how the possible pay-out per country would be calculated and to what extent countries would be given an indication in advance of the budget available for their plan.
- Some countries were worried that delays in the premium payment for their annual ARC insurance might impact their access to and eligibility for the XCF.
- Some countries highlighted that DRR and adaptation activities are typically handled by different sectorial departments/ministries in-country and the implementation of a coordination structure would be needed. Building on and augmenting existing in-country ARC Technical Working Group structures would strengthen engagement and help with coordination.
- Countries would welcome the opportunity to submit regional adaptation investment plans to be implemented by one national entity (for example the Centre for Ecological Monitoring in Senegal which could submit joint projects for Senegal and Mauritania as both countries are vulnerable to similar climate risks in the Sahel region).
- In terms of the future country engagement process, countries recommend to follow the same structure and process as for current ARC insurance, starting with a scoping mission to engage national stakeholders, bringing in the right ministries and setting up sectorial working groups to carry out necessary technical work and make recommendations.

These elements shall be taken into considerations when engaging in the next steps of the XCF design phase.

This being said, countries overall approved of the opportunity to access potential additional funding for their adaptation investment plans through the XCF and of the proposed 3-step process offering them a possibility to address gaps and build capacities as part of the process. The idea of the XCF building upon ongoing in-country work linked to the United Nations Framework Convention on Climate Change (i.e. Intended Nationally Determined Contributions, National Adaptation Plans, Climate Change strategies, accreditation process for the GCF) was especially well received by the audience.

### **Conclusion and way-forward**

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This three-step approach should allow ARC to provide value-for-money for its Member States by providing them with the flexibility required to have them successfully access the XCF and build their long-term resilience, without making it a burdensome process given the uncertainty that a pay-out may or may not result. Another key benefit of the proposed process is that it allows countries to develop their capacities for financial management and project implementation, which will increase their ability to access other international climate funds. The investment criteria selected for the second and third steps reflect the essential elements of the prospective XCF adaptation investment

plans and aim to ensure that the plans meet key adaptation and DRR aims while emphasizing financial effectiveness.

As described above, the overriding concern was finding the right balance between international best practice and robust standards on the one hand, and a practical level in line with current realities on the continent that will allow the facility to begin operations in the near term on the other. As such, the proposed three-step country engagement process was designed to minimize the up-front burden on ARC's Member States to be eligible to participate in XCF, while providing them with an opportunity and incentive to fill in critical capacity gaps in the early years of the program, before demonstrating their robust fiduciary and project management capabilities. This sequencing of requirements aims to maximize the value of the exercise for the countries, while still ensuring that necessary safeguards are in place for the ARC Member States and donor partners.

While certain details will need to be fleshed out in collaboration with the ARC, its Member States and its partners, depending on their priorities and evolving vision for this facility, we propose using these criteria and evaluation process as a point from which to begin a more in-depth discussion with countries' representatives and stakeholders. Substantial marketing activities to present the XCF and a strong political engagement within countries will be key for a successful implementation of the new financial mechanism.

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