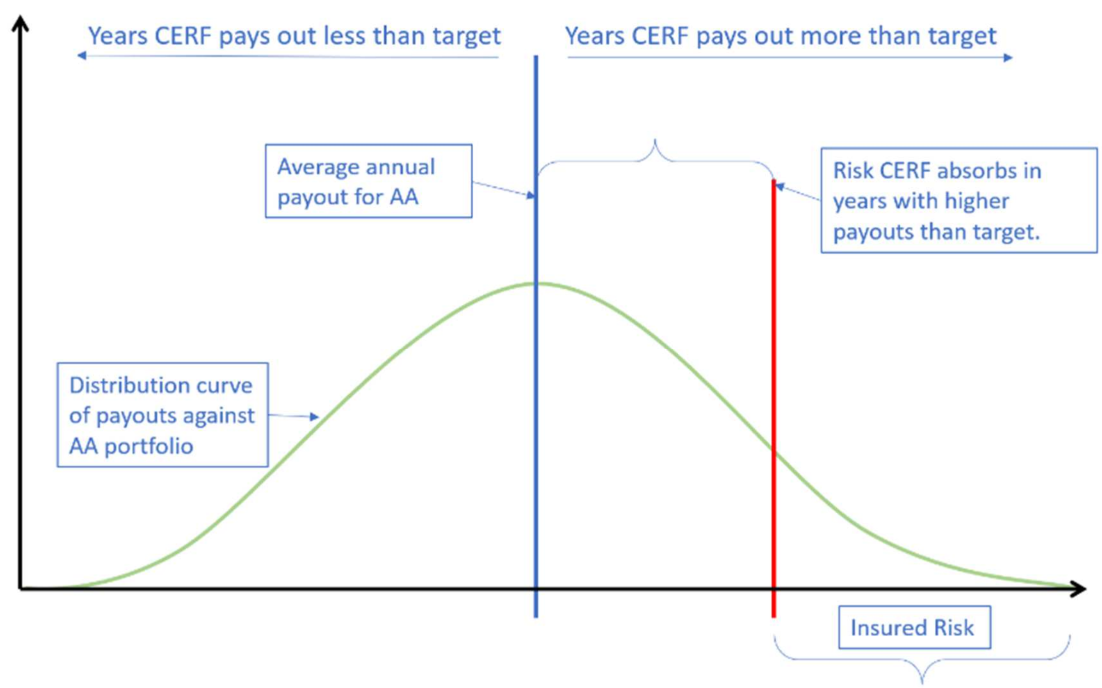
In June 2024, the CERF Advisory Group engaged in a discussion on the exploratory work undertaken by the Office for the Coordination of Humanitarian Affairs (OCHA) on risk transfer mechanisms, to enhance the reach of CERF's anticipatory action (AA), as well as alternative financing modalities such as wealth funds, taxes, and levies.

This document serves as an update on OCHA's progress in identifying a risk transfer solution.

Rationale: Why risk transfer?

Over the last two years, roughly a third of CERF funding has been allocated toward climate shock responses. Conflict, climate change, disease outbreaks, and economic shocks continue to affect millions of people and to stretch CERF's ability to deliver. At the same time, there is a growing demand for pre-arranged financing for AA. Recognizing this evolving landscape, OCHA has begun exploring innovative financing solutions such as the use of insurance to protect and scale up CERF's future capacity to anticipate and respond to crises.

CERF pre-commits funding against a portfolio of anticipatory action frameworks. It is not possible to predict how many frameworks will activate in a given year (it can range from zero to all). In an *extreme year*, if most or all frameworks were to activate, reduced liquidity would compromise CERF's capacity to respond to concurrent crises. Backstopping CERF's AA portfolio with an insurance mechanism would not only safeguard CERF's liquidity but also enable OCHA to expand the AA portfolio.



Financial risk exposure model and portfolio analysis

Before zooming in on possible insurance solutions, OCHA's first step has been to gain a deeper understanding of the financial risk CERF holds in its current AA portfolio and use that knowledge as a forward-looking planning and fund management tool.

To that end, OCHA's Centre for Humanitarian Data (CHD), with expert inputs/validation by the Centre for Disaster Protection (CDP), developed a model to calculate the probability of framework activations exceeding CERF's current annual AA target (i.e., ~10% of CERF). The following are the takeaways from the modeling undertaken by OCHA and CDP, based on CERF's decision-making rules, governance, and operations:

1. **The CERF AA portfolio is insurable.** The current portfolio contains a diverse range of shocks and geographies for events that occur between once every three and once every five years. After running the model millions of times, "extreme years" were a rare occurrence. These observations by CDP also validate OCHA's approach to defining the composition and value of the portfolio, and the choices of triggers and thresholds for the release of pre-arranged financing.

2. **CERF can already safely hold more risk.** Although the CERF AA portfolio is insurable, insurance is not necessarily optimal yet. In fact, CERF still has room to increase the current level of pre-arranged financing for AA without incurring any significant liquidity risk. This is an important consideration for short-term decision-making regarding the approval of AA frameworks in 2025.

3. **Risk can grow quickly**. OCHA used the model to simulate the effect of increasing the volume of pre-arranged funding for AA. With a growing portfolio, between $150m and $200m, the probability of exceeding the CERF's annual target for AA allocations increases to more than 25 percent[1]. In some of those years, the payouts might be significantly higher than the target. In these scenarios, it may make sense for OCHA to transfer a portion of the risk –instead of absorbing all the risk– in its portfolio.

4. **Discovering the most efficient point at which insurance is optimal**. In 2025, OCHA could engage brokering consulting services to start developing a risk transfer solution that enables CERF to protect its liquidity in extreme years and, at the same time, expand the AA portfolio. This process will help OCHA identify the most efficient point (or range) at which insurance is optimal, meaning, how much protection OCHA might need and how much such a product could cost.

5. **Working today on the type of solutions needed to meet future challenges.** CERF is currently the largest global source of pre-arranged financing for AA. Protecting and expanding CERF's financial commitment is a strategic investment in the collective ambition to make the humanitarian system as anticipatory as possible. A risk transfer solution for CERF is not urgent today but it will be critical in the next 2-5 years.

Next steps

- OCHA will continue working, alongside partners like CDP, toward a risk transfer solution.
- In 2025, OCHA will focus on engaging the brokering consulting services needed to deliver a viable product.
- As the work evolves, OCHA will continue to engage donors, private sector partners, and stakeholders to mobilize eventual premium financing.
- FCDO has recently generously approved a grant of half a million GBP to enable OCHA to invest in the product development phase envisioned in 2025.

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[1] As CERF is projected to see a decrease in income in 2025 and potentially beyond, the relative AA risk may increase even before portfolio growth.