How should national societies in the Red Cross/Red Crescent movement relate to humanitarian innovative finance?

Report commissioned and financed by the Swedish Red Cross

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September 2023

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Abbreviations and Acronyms

BRC	British Red Cross
CHF	Swiss Francs
DAC	Development Assistance Committee
DFI	Development Finance Institution
DFID	UK Department for International Development
DRC	Democratic Republic of Congo
DREF	Disaster Response Emergency Fund
ESG	Environmental, Social and Governance
EU	European Union
EUR	Euro
HFF	Humanitarian Finance Forum
HIB	Humanitarian Impact Bond
HIF	Humanitarian Innovative Finance
HIFHUB	Humanitarian Innovative Finance Hub
ICRC	International Committee of the Red Cross
LIC	Low Income Country
LMIC	Lower Middle Income Country
IFAD	International Fund for Agricultural Development
IFRC	International Federation of the Red Cross
ILS	Insurance Linked Securities
M&E	Monitoring and Evaluation
MDB	Multilateral development bank
MFI	Micro Finance Institution
MSME	Micro, Small and Medium-Sized Enterprises
NGO	Non-Governmental Organization
NS	National Society
ODA	Official development assistance
OECD	Organization for Economic Co-operation and Development
RDDCM	Rapid Disbursing Debt Conversion Mechanism
RCRC	Red Cross Red Crescent
SDG	Sustainable Development Goal
Sida	Swedish International Development Cooperation Agency
UN	United Nations
UNHCR	United Nations High Commissioner for Refugees
US	United States of America
USD	United States Dollars
WASH	Water Sanitation and Hygiene

Executive Summary

While the traditional humanitarian finance model based on grants from state actors, the general public, corporates, and philanthropic organizations, will remain dominant for crisis response for the foreseeable future, Humanitarian Innovative Finance (HIF) has a considerable potential role to play, particularly for crisis prevention, for adaptation and resilience building as well as for reconstruction pos-conflict and pos-crisis. HIF may also play a considerable role in rapid crisis response through insurance-based solutions. Creative partnerships and HIF solutions may therefore play a vital role in filling the finance gap driven by the scale and especially the duration of today's humanitarian crises.

Attracting investments for HIF projects from non-traditional sources, from e.g., institutional and impact investors for humanitarian purposes is challenging due both to high perceived as well as real risks and not the least the need for investable opportunities. Although many HIF initiatives are still quite recent and untested at scale, there are nevertheless several pilot projects and finance structures that may serve as models and a source of lessons learned going forward.

Institutional investors look to invest in long-term assets and increasingly value environmental, climate and social dividends as an integral part of overall return on investment. This will likely further increase private sector interest to finance the Sustainable Development Goals (SDGs), including financing for humanitarian purposes, both in the short, mid, and long term, should the investment risk/return profiles be acceptable.

For the Red Cross Red Crescent (RCRC) movement to contribute to and ensure a sustainable and sustained increase of investment in HIF vehicles, strategic alliances with other humanitarian actors, engaging with institutional investors and fund managers, and leveraging external expertise are crucial. A culture of shared learning within the RCRC movement, as well as increased coordination and transparency, will further the humanitarian innovative finance investment agenda.

A national RCRC society, investing adequate human and financial resources, as a convener of national state actors, civil society, corporations, and institutional investors, could make important contributions to the emerging HIF agenda within the RCRC movement in collaboration with other interested and active National Societies (NS) already active in this area.

I. Introduction

Financing of the global humanitarian aid system faces great challenges, suffers from a chronic funding shortage and is under high pressure from several ongoing long-term humanitarian crises affecting millions of people.

While traditional donors continue to provide grant funding at legacy levels to the RCRC movement and other emergency responders, such as United Nations (UN) agencies and Non-Governmental Organizations (NGO), the gap between needs and funding has widened in recent years.

Reform initiatives with the intent to improve funding efficiency and coordination have been launched over the last several years with mixed results, and in order to solve the constant underfunding of humanitarian needs, there is a growing momentum among humanitarian aid actors to employ a broader range of financial tools and to develop and scale up HIF solutions to address humanitarian funding needs.

We might have reached an opportune moment to implement HIF solutions at scale as institutional and impact investor interest in long-term assets with a focus on incorporating Environment, Social and Governance (ESG) returns alongside acceptable financial returns, is growing, not only in OECD countries, but also in emerging markets and developing countries.

In addition, traditional humanitarian donors and foundations show and increasing interest in blended finance[1] structured to leverage limited grant funding to attract and leverage capital from institutional and impact investors.

A. Overview of the current humanitarian aid finance landscape

The current humanitarian aid finance landscape consists of a complex matrix of actors including the RCRC movement and other humanitarian aid providers, donor governments and philanthropical funding sources, that all aim to address needs of people affected by war, crises, and disasters worldwide.

Although the end goal is the same, all humanitarian aid actors, not different from development aid actors in general, also have their own agendas and constraints. Although there is considerable cooperation and coordination on local levels between e.g., RCRC NS and local units of the United Nations High Commissioner for Refugees (UNHCR), efficient global coordination and pooling of resources for humanitarian aid seem to be lacking.

Even though there are innumerous humanitarian aspects of the SDGs, and in a way all SDGs promote improving the human condition, humanitarian aid at the same time

[1] The OECD defines blended finance as the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries. https://one.oecd.org/document/DCD/DAC(2020)42/FINAL/En/pdf

seems somewhat disconnected from the SDG agenda. The humanitarian-development divide has already been debated for quite some time and there seems to be a need to better align humanitarian aid with the SDGs and to be seen as an integral part of achieving the SDG goals. Innovative and blended SDG finance vehicles could possibly play a role in bridging the gap by integrating humanitarian aid as a part of projects being financed.[2]

Despite the availability of donor funding, humanitarian needs often outpace available resources. A chronic funding gaps persist, especially for prevention, resilience, rebuilding and for prolonged humanitarian crises that are no longer in the mass media limelight, leading to unpredictable and inadequate funding levels, posing challenges for effective planning and response.

The COVID-19 pandemic and the war in Ukraine have further strained resources and highlighted the need for not only increased investment in preparedness, resilience, and rebuilding, but also for rapid crisis response. Coordinated efforts among governments, multilateral organizations, NGOs, and the private sector are crucial to address the humanitarian funding needs going forward.[3]

B. Importance of innovative finance for the RCRC movement

Engaging with existing and new partners and developing innovative finance solutions at scale and in a coordinated way could bring substantial additional resources for the RCRC movement to fund and support its activities and operations.

The systematic and programmatic usage of HIF solutions may be particularly important and useful to address the gap between emergency humanitarian aid and long-term needs for funding of rebuilding efforts in protracted crises and complex humanitarian challenges. Long-term engagement and solutions may shift the focus from aid recipients being passive victims of disaster or war to become active economic and social actors.

Additional funding from non-traditional sources through innovative finance mechanisms may provide additional financial and organizational sustainability and resilience for the RCRC movement, especially addressing long-term humanitarian goals during times of global economic uncertainty and when there are competing immediate humanitarian needs.

Engaging in HIF stimulates and facilitates partnerships with private sector actors, leveraging their expertise, resources, and networks. This collaboration may also result in other innovative ideas, technologies, and approaches for the RCRC movement, leading to more efficient and impactful humanitarian interventions overall.

[2] https://www.un.org/esa/desa/papers/2019/wp160_2019.pdf
[3] https://devinit.org/documents/1350/GHA2023_Digital_v9.pdf

By embracing HIF, a NS, or a group of NSs can serve as a testbed for experimenting with new approaches and finance models that may foster a culture of innovation and change benefitting the RCRC movement as a whole.

However, it's important to also consider the potential challenges and risks associated with HIF for the RCRC movement and for individual NSs. These may include regulatory and legal aspects, potential conflicts of interest, ethical considerations, the need for capacity building to effectively implement and manage innovative finance initiatives and organizational change management, and for the RCRC movement as a whole, not the least, to manage branding and organizational neutrality aspects.

Ultimately, the decision for the RCRC movement or a particular NS to further engage in HIF should take the organization's strategic goals into consideration, weighing the potential benefits and risks involved especially evaluate the preparedness for organizational change management and capacity building to implement and manage such initiatives. To be successful, it will require a substantial cultural change within the organization.

II. Humanitarian innovative finance actors and initiatives

Developing, structuring, and implementing finance vehicles in a fragile context is challenging and requires investment of time, knowledge, and patience. Over the last several years, however, several HIF initiatives have been launched by the RCRC movement and others.

A. Principal RCRC humanitarian innovate finance actors

There are several actors within the RCRC movement that promote and develop HIF solutions, both at the central ICRC/IFRC level and in various NS, where the Danish Red Cross and the British Red Cross are probably the most active.

Coordination of HIF efforts seem however to be lacking to a considerable extent within the RCRC movement. In addition, there is no defined common goal and understanding of that the RCRC movement wants to achieve in this area.

The newly established Humanitarian Innovative Finance Hub (HIFHUB) at the Danish Red Cross could be in a great position to take the lead to better coordinate RCRC humanitarian innovative finance initiatives and the organizational change management needed for a more focused RCRC HIF approach.

1. ICRC

ICRC has a dedicated HIF team, and its most well-known project so far has been the now concluded Humanitarian Impact Bond (HIB) for the establishment of physical rehabilitation centers. Please see Section III.A. for more details.

Other initiatives consist of the ICRC Climate and Environment Transition Fund, to make ICRC's own infrastructure and operations greener to generate considerable reduction of CO2 emissions, possibly ultimately generating income from selling carbon credits. ICRC also acts as an enabler and convener of financial and human resources for the Goma West Resilient Water Project. Please see section II.C.5 for a more detailed discussion of the Goma project.

2. IFRC

IFRC also has a dedicated HIF team and has launched innovative finance initiatives like the Global One Wash finance mechanism together with the Islamic Development Bank with the aim combat and eradicate cholera by 2030.

The flagship innovative finance initiative is however the development of an insurance policy that will provide additional funding for replenishment of IFRC's Disaster Response Emergency Fund (DREF), if and when allocations to natural disasters from the fund have exceeded a predetermined threshold amount during a particular year.

DREF, which closed in the beginning of September 2023, is set up to pay out an extra CHF 20 million during exceptional years with unforeseen DREF natural disaster allocation requests.

For IFRC the insurance policy will ensure DREF's capacity to deliver funding for emergency assistance at a larger scale and with greater impact and for more natural disasters if and when a need therefore arises. NSs can thus dependably access DREF funding without any disruptions to operations and emergency responses.[4]

The insurance fee will be covered by IFRC's own resources together with contributions from the British Red Cross, the Danish Red Cross, UK Foreign, Commonwealth & Development Office and Nestlé, matched by funding from the InsuResilience Fund[5]. The British Red Cross has been leading the structuring and documentation of the insurance policy together with IFRC and with in-kind support from Aon.

3. Danish Red Cross

The Danish Red Cross has developed a considerable number of interesting HIF concepts over the last several years, supported by the Danish Ministry for Foreign Affairs and other partners.

The parametric Volcano Bond is a an already implemented initiative as a result of this work (pls see section III.C).

In Malawi the Danish Red Cross is also developing a solution for a possible sovereign debt swap based on possible debt reductions by bilateral creditors, to release funding

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[4] https://www.theglobalcity.uk/resources/case-study-catalogue-2023
[5] https://insuresilience-solutions-fund.org/

for humanitarian purposes in Malawi. In Malawi, the Danish Red Cross is also developing an insurance-based solution for flooding emergency response.

The Danish Red Cross is also actively working to set up a Humanitarian Health Investment Fund, an evergreen fund that will invest in startups in the health sector to promote innovation. The fund will have junior capital from grants and private investors providing senior capital. In the pilot phase the size of the fund is planned to be in the €4-5 million range. After the pilot phase, if the structure has proven its worth, the fund could become an investment tool for the entire RCRC movement. The first target countries are Kenya and Ethiopia.

In the health sector the Danish Red Cross is also at the concept stage of a possible diabetes prevention impact bond, potentially in Lebanon and Bangladesh.

The Danish Red Cross has also developed a mangrove development and resilience project in the Philippines based on parametric insurance and carbon credits called the Mangrove Trust Fund. The initiative has been handed over to the Philippines Red Cross and the Netherlands Red Cross, with presence in the Philippines, for further detailed development and documentation work.

The Mangrove Trust Fund finance facility aims to implement a multicomponent finance system that will protect communities from the effects of typhoons and will restore and reforest up to 30,000 hectares of mangroves in the Philippines. The facility will utilize the sale of carbon credit call options and warrants to increasingly cover the insurance fees for an Insurance Linked Securities (ILS) typhoon catastrophe (CAT) bond to eventually make the finance facility self-sustainable.

The ILS CAT bond will pay out if a typhoon reaches a force 12 wind speed (33m/s). Should a typhoon hit, the insurance payout will be used to rebuild coastal communities and replant damaged mangrove.[6]

4. Humanitarian Innovative Finance HUB (HIFHUB)

HIFHUB has a dedicated team (currently approx. 4,25 full time employees), is hosted by the Danish Red Cross and currently funded by a grant from the Danish Ministry of Foreign Affairs.

HIFHUB is dedicated to advancing the use of HIF mechanisms within the RCRC movement and to find ways to increasingly use HIF solutions for RCRC.

HIFHUB pursues this by focusing on three intervention areas: a) Extending knowledge, awareness, and literacy in innovative finance within the RCRC movement, b) providing direct support to piloting, scale-up, and anchoring of innovative finance models, and c)

[6] https://sebgroup.com/siteassets/cision/documents/2022/20220915-sebs-green-bond-report-accelerated-transition-held-up-before-2023-take-off-en-gb-0-3155392.pdf

contributing to forming enabling environments for innovative finance, including the organizational readiness of partners.

HIFHUB works closely with partners within and outside the RCRC movement to explore HIF opportunities. HIFHUB's goal is to serve as a RCRC movement wide resource, being an anchor point for the development of knowledge on HIF and the initiation and scaling of HIF initiatives in the RCRC movement and taking an active role in brokering partnerships both internally and externally for the progression of HIF within the RCRC movement.

Formally launched in 2023, the number of HIFHUB initiated projects is limited, but HIFHUB is or has been involved in active collaborations with NSs in Asia, Africa, Europe, and Latin America. These include e.g., CAT bonds, sovereign debt conversion programs, and livelihood programs enhanced by blockchain technology.[7]

5. British Red Cross (BRC)

BRC is quite active in the HIF space and like already mentioned above, is together with IFRC one of the two main developers and sponsors of the DREF insurance policy.

Another interesting initiative is the work BRC is doing together with other RCRC entities, International Finance Facility for Immunization (IFFIm), and representatives from the capital market in the Humanitarian Finance Forum (HFF), to promote the use and knowledge of capital markets to support humanitarian goals. HFF seeks to utilize the rapid growth of ESG investing to develop and encourage private investments for humanitarian purposes. HFF convenes expert groups to provide critical analyses of ideas, concepts, and approaches to financing humanitarian impact via capital markets.

One HFF idea is for RCRC to emulate the IFFIm bond program. IFFIm is a financial mechanism that raises funds in capital markets to accelerate the funding and availability of vaccines in developing countries. By issuing bonds, IFFIm converts long-term donor pledges into immediate funds for the Global Vaccine Alliance, Gavi. Emulating the IFFIm bond program could be a major game changer for funding of the RCRC movement. As it was for Gavi.

6. Other RCRC NSs active in humanitarian innovative finance

The Netherlands Red Cross has a team working on HIF and is currently investing time and effort to make the Mangrove Finance Trust a reality, working closely with the Philippines Red Cross, HIFHUB and third parties. The team is however dependent on a sign-off from the management of Netherlands Red Cross to move forward.

[7] https://www.rodekors.dk/sites/rodekors.dk/files/2023-03/Two%20Pager%20-%20Hub%20at%20a%20Glance%20Formatted_0.pdf?_gl=1*m0u58j*_gcl_au*NTc0NTAyMzI2LjE2ODc0MzE0NjU.

The Netherlands Red Cross also hosts 510, a unit that uses data analysis to better plan humanitarian aid and humanitarian investments.[8]

The Australian Red Cross has structured a parametric insurance policy for cyclones in the Pacific for 2,7 million Australian dollars but has so far been unsuccessful in raising the 252,500 Australian dollar/year insurance fee requested by the issuer of the policy.

The Spanish Red Cross also actively tries to tap into innovative funding sources. The Kenya Red Cross is an active member of the HIFHUB Sponsor Group.

B. Examples of humanitarian innovative finance initiatives

Both ICRC and IFRC together with several NSs, as well as the World Bank and multilateral development banks (MDB), development agencies and donors, have dedicated time, effort, and resources over the last several years to develop, structure and implement innovative finance mechanisms and solutions for humanitarian aid.

1. Impact bonds

Impact bonds for humanitarian purposes get a lot of attention but the number of impact bonds is still modest and average impact bond sizes are low.

Brookings track the number and volume of impact bonds on a continuous basis and in their latest publication (June 2023), so far, a total of 247 impact bonds in 40 countries have been contracted globally, out of which Brookings classifies 229 as Social Impact Bonds and 18 as Development Impact Bonds. Average duration for all impact bonds contracted is 52 months with an average upfront capital of US$ 3.27million. The total number of impact bonds in LICs and LMICs is a meager 32 and India is the country with the most impact bonds with a total of four.[9]

Most impact bonds have been contracted in the US and UK, possibly because of a generally favorable and predictable legal and institutional framework. Impact bonds often require complex documentation that has a tendency to be harder to structure and enforce in a LIC an LMIC setting.

Although impact bonds have the structural advantage of frontloading funds for a project, they often suffer from a costly, lengthy, and complicated structuring process, multiparty negotiations, low financing volume and extensive documentation.

Pls see section III.A for a case study of the ICRC Humanitarian Impact Bond.

[8] https://www.510.global/

[9] https://www.brookings.edu/articles/social-and-development-impact-bonds-by-the-numbers/

2. MSME and entrepreneur finance vehicles in fragile settings

Finance vehicles for refugee and host community entrepreneurship may contribute to financial market development in fragile contexts not only by promoting financial inclusion but also by strengthening host country capital markets and financial institutions.

For example, Nasira, a risk-sharing guarantee facility managed by the Dutch Development Bank FMO, and partly underwritten by a guarantee from the European Commission, supports local financial institutions in lending to underserved market segments such as women, youth, and refugee business owners through portfolio guarantees to local banks, thereby narrowing the financing gap and stimulating overall market activity.[10]

Pls see section III.B for a case study of a credit facility for refugee and host communities in Uganda guaranteed by the Swedish International Development Cooperation Agency (Sida).

3. **Parametric Insurance**

Parametric insurance is a type of insurance policy that pays a predetermined amount based on the occurrence of a specific event, regardless of actual losses incurred. Parametric insurance solutions facilitate risk transfer to institutional investors on the ILS market.

Unlike indemnity insurance, issued and covered by traditional insurance and reinsurance companies, parametric insurance is covered by institutional investors in the ILS market, and eliminates the need for claims adjustment and therefore allows for faster payment to policyholders. Parametric insurance is therefore particularly useful to cover natural disaster and catastrophe risk, where time is critical to deliver a disaster response. Parametric insurance may be up to 3.5 times faster in providing funding for disaster response compared to traditional funding, according to a study commissioned by the former UK Department for International Development (DFID).[11]

There are several examples of market based parametric insurance policies. The Caribbean Catastrophe Risk Insurance Facility insures Caribbean governments against hurricanes and earthquakes, while the African Risk Capacity pools funds from African Union member states to provide coverage against climate risks. SwissRe's Insur8 is a typhoon warning parametric insurance product designed to mitigate business interruption risk in Hong Kong. AXA climate offers parametric insurance for weather-related risks, and RMS provides parametric coverage for hurricanes, earthquakes, and windstorms.

[10] https://www.fmo.nl/nasira
[11] https://content.naic.org/cipr-topics/parametric-disaster-insurance

A major drawback and complicating factor of parametric insurance is basis risk, as economic losses may not align with the insurance coverage amount or the trigger threshold, i.e., the basis, for payout is not reached. Basis risk can however be reduced through improved risk modeling capabilities of the insurer and the insured.

Parametric insurance can also work alongside and complement traditional indemnity insurance policies, combining immediate payouts with a claims adjustment process.

Parametric insurance enables humanitarian organizations to act in advance and be prepared for potential natural disasters, as payout is based on objective scientific data, and not on an often subjective loss assessment by an insurance company. Simultaneously, indemnity insurance has value in providing funds for the recovery phase of a disaster response, when actual losses can be evidenced and initial costings for response by a humanitarian agency can be revised, in order to better provision for the rebuilding phase.

Regulation specific to parametric insurance is limited, with most countries applying the same regulatory framework as for traditional insurance policies. This lack of specific regulation of parametric insurance may however pose challenges in jurisdictions where principles of indemnity or contingency are used.

Although basis risk and regulatory challenges exist, parametric insurance has a potential of playing a great role in the overall funding needs of RCRC emergency response and operations. The standardization of parametric insurance policies and the link to the ILS market are factors that could contribute to its expansion.[12]

Please see section III.C for a case study of the Volcano Parametric Bond, structured and launched by the Danish Red Cross.

4. Humanitarian project finance, RCRC as a convener and enabler

The Goma West Water Resilience project is an initiative being implemented by the ICRC in Goma, DRC, where ICRC has acted as a project developer, initial investor and convener, collaborating with a great number of interested RCRC NSs as well as with external stakeholders and partners. The project will improve access to safe and reliable water supply for the refugee and vulnerable population in the Goma area.

The project has gone through different phases to ensure both emergency response and long-term needs. In the initial stage, feasibility studies and emergency interventions were conducted to address immediate water needs. This involved providing clean water, rehabilitating existing water systems, and establishing emergency water supply networks.

[12] https://content.naic.org/cipr-topics/parametric-disaster-insurance

The subsequent phase of the project focused on the design, construction, and operation of a sustainable water infrastructure with the goal to implement a fee-for-service model.

The project intends to strengthen water governance, improve water infrastructure resilience, and to capacitate local water service providers. By adopting an integrated approach, the project seeks to address not only the immediate water needs of the population but also to solve the long-term challenges related to water supply and management in the region.

Ultimately, the project aims to benefit half a million people, particularly those who are the most vulnerable and marginalized in Goma, by providing sustainable access to safe water. ICRC thinks that the Goma project model could be replicable in other fragile contexts in Africa and the Middle East, contributing to improved water resilience and livelihoods in conflict-affected areas.

The Goma West Water and Resilience project is a good example where the RCRC movement through its field work identifies a problem, takes immediate action to address emergency needs, and takes the initiative to develop and document a project blueprint for a more permanent solution, convening and engaging with local and international stakeholders to this end.

The RCRC movement acting as a project identifier, developer, enabler, and convener is a highly replicable concept to generate funding for specific humanitarian needs and challenges.

6. Sovereign debt swaps

Sovereign debt swaps have so far mostly been used to promote and release funding for environmental and climate related purposes, so called Debt for Nature swaps. One of the first finance structures of this kind was the Seychelles Blue Bond, sponsored and structured by The Nature Conservancy, an American NGO. It was characterized by a complex and lengthy structuring process, involving a great number of stakeholders. Discussions started already in 2012 and the blue bond closed in 2017.[13]

Sovereign debt swaps are based on partial debt reduction of a country's debt to Paris Club members or a select group thereof.[14] Although the mechanism may seem attractive for debtor nations at first glance, getting a discount on amounts owed, a debt swap may also negatively affect a country's sovereign credit rating and the willingness of creditors to extend new financing to that particular country. There is also the risk of debtor moral hazard, creating an incentive to default on sovereign debt, and the Paris

[13] https://www.unescap.org/sites/default/d8files/event-documents/3.3_Financing%20blue%20economy_The%20Seychelles%E2%80%99%20experience_JP%20Adam.pdf

[14] Paris Club is a group of major creditor countries whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor countries. https://clubdeparis.org/

Club has expressed that it is not keen on sovereign debt swaps developing into a standard for debt renegotiations at a larger scale under the auspices of the Paris Club.

However, if a debt swap is done for sovereign debt to private creditors and on market like terms, substantial amounts of sovereign debt that are not subject to the scrutiny of the Paris Club may be converted, like in the recently closed debt for nature swap in Ecuador.[15] This is a concept that should be studied further by the RCRC movement.

ICRC recently published an innovative approach to sovereign debt swaps for humanitarian purposes, discussed in section III.D.

6. **Humanitarian aid as an integrated part of SDG finance vehicles – the humanitarian aid and climate finance nexus**

A potentially promising field to increase funding for humanitarian aid is the hitherto little explored opportunity to bundle and include humanitarian aid related actions and activities in SDG finance mechanisms and vehicles, particularly for SDG 13, Climate Action, and then especially in connection with finance for climate adaptation and resilience.

Investments in climate adaptation and resilience have an intrinsic humanitarian aspect and introducing investment in humanitarian aid as a use of proceeds in climate adaptation and resilience finance vehicles could be a great opportunity for increased funding for humanitarian purposes, particularly for crisis prevention and avoidance, but also for rebuilding after a natural disaster or conflict. In addition, investing in and focusing on the humanitarian aspects of a climate adaptation and resilience investment may also have a credit risk mitigation effect for the project as a whole.

Climate adaptation and mitigation projects often face challenges related to social acceptance and stakeholder engagement. Including humanitarian aid in the use of proceeds demonstrates a commitment to addressing social and human environmental concerns. That may support the project's legitimacy, garner support from local communities, and build partnerships with relevant local stakeholders. Strong social acceptance and stakeholder support may contribute to project success and also reduce overall credit risk for investors.

III. Humanitarian innovative finance case studies

In this section, four examples of innovative finance structures for humanitarian aid will be explored in more detail.

[15] https://www.ft.com/content/e895761d-63c6-44e7-84d8-ca6dd89a6a20

A. Humanitarian impact bonds for rehabilitation centers in Mali, Nigeria, and DRC

1. Overview of the initiative

The ICRC Humanitarian Impact Bond (HIB) was launched in September 2017 with a duration of five years and provided financing for specified activities within ICRC's Physical Rehabilitation Program, which has been providing physiotherapy and access to mobility devices since 1979. ICRC operates over one hundred of these centers worldwide.

HIB covered the construction costs of three new rehabilitation centers in Mali, Nigeria, and DRC and provided operational support for two years following their opening. This included training of additional staff and the implementation of new IT tools.

The primary HIB goal was to support a minimum of 3,600 individuals, who have physical disabilities resulting from war, natural disasters, congenital impairments, or disabling diseases, in regaining their mobility. [16]

Location	Focus	Upfront Investment	Outcome Funding	Return (Min-Max)
Mopti, Mali; Maiduguri, Nigeria; Kinshasa, DRC	Physical rehabilitation services	US$19,700,000	US$27,600,000	-11.3% to 7% p.a. based on Staff Efficiency Ratio (SER)

If projected SER target outcomes were achieved, private investors would receive 100 percent of their upfront investment back. If HIB achieved SER outcomes above the prespecified target levels, investors could receive a maximum of 7% p.a. return on their investment.

If SER outcomes were not achieved, investors could lose up to 40% of their original investment and subsequently get a negative yield of up to -11.3% p.a. ICRC also faced a downside financial risk and would repay a portion of private investors' upfront investment if the staff efficiency ratio in new centers did not reach 100 percent of the level of the defined baseline SER average of already operating rehabilitation centers.[17]

Outcome funders were government agencies from Belgium, Switzerland, United Kingdom, and Italy, and the La Caixa Foundation. Government of Netherlands supplied

[16] https://www.jstor.org/stable/pdf/resrep29600.6.pdf?refreqid=excelsior%3Af4214c44f7c2d5b688f404cbee9a2d53&ab_segments=&origin=&initiator=&acceptTC=1

[17] KOIS Invest 2017

grant financing for the HIB design and structuring. HIB private upfront investors were Munich Re and a consortium of nine investors coordinated by Lombard Odier.

Outcome payments were estimated and negotiated by ICRC, the outcome funders, and the private investor group. Philanthropy Associates was chosen to independently evaluate and verify the achievement of the outcomes of the impact bond.

La Caixa Foundation committed to pay out their part of the outcome funding after the opening of the new rehabilitation centers scheduled for July 2020. The rest of the outcome funders committed to pay out in September 2022 based on the measured SER outcome. The SER of the three new centers was compared to a baseline average calculated from existing ICRC rehabilitation centers with similar characteristics in their second year of operations.

2. Achievements and outcomes

At the close of the HIB, in July 2022, the combined SER demonstrated that the new centers were 9% more efficient than the baseline, resulting in an Outcome Measure of 1.09.

A near 10% increase in the overall efficiency of the new centers was considered significant by ICRC, particularly in view of the different challenges encountered: the COVID pandemic in addition to significant security constraints in Mali and Nigeria.

The Outcome Measure of 1,09 resulted in a full reimbursement of the capital amounts invested, however resulting in no financial return for the investors.[18]

3. Lessons learned and best practices

For ICRC the HIB brought quite a few tangible results.

Three new rehabilitation centers were built, and the construction and operational risks were partly transferred to the private sector.

HIB provided multi-year flexible funding and ICRC engaged with new partners and with old partners/donors in new ways.

New operational efficiency measures were developed and tested within the HIB framework and a new data management system was built that may be rolled out across the ICRC organization.[19]

However, based on interviews with key people that were involved in the HIB, ICRC is not planning a new impact bond to build additional rehabilitation centers, or for any

[18] https://golab.bsg.ox.ac.uk/documents/15._Master_Slide_Deck_1.pdf
[19] idem

other purpose for that matter, any time soon. The reasons therefore are manifold, including,

- The HIB was characterized by a long and costly financial structuring and documentation process. The HIB took several years to get in place. Many different parties were involved, and it was difficult, time consuming and cumbersome to manage different interests and expectations, both internally and externally.
- All impact bonds are bespoke by nature and costly to structure, have low replicability and require lengthy negotiation of goals, metrics, triggers, and financial returns between the parties involved. Only the impact bond concept and philosophy as such is replicable.
- An impact bond for the same specific purpose, i.e., for the construction of additional ICRC rehabilitation centers, is not needed and will not be repeated. The learning and best practices that the ICRC HIB resulted in will however be incorporated in the planning of future construction of additional rehabilitation centers.

B. Access to financial services for refugees and host communities in Uganda

1. Overview of the initiative

In the beginning of 2020, Sida, UNHCR, and the Grameen Crédit Agricole Foundation (GCAF) launched a four-year program to promote access to financial and non-financial services for refugees and host communities in Uganda.

The goal was to finance three MFIs in Uganda through a credit facility of up to EUR 5 million for the 2020–2024 period. 50% of the GCAF capital at risk is covered by a Sida guarantee. The credit facility gives access to funding on favorable terms for MFIs providing loans to refugees and host populations in Uganda. The primary target is supporting entrepreneurs in the refugee and host communities.[20] Sida also provided funding of technical assistance for business training and financial education for potential borrowers.

The credit facility is designed to incentivize both microfinance investors and MFIs to extend their financial services to refugee and host populations.

At the launch of the credit facility, it was expected that up to 100,000 refugees and host community members, out of which 70 percent women, would get access to financial services, both credit and savings. The loans extended through the credit facility support the creation and development of MSME businesses in e.g., farming, handicrafts, catering, and trading.

[20] https://cdn.sida.se/publications/files/sida62295en-guarantee-portfolio.pdf

Uganda's refugee policy favors social and economic inclusion of refugees, and the finance facility was considered to contribute to refugee adaptation as there are limited employment opportunities for most refugees in the country. Refugees in Uganda generally lack access to formal financial services, mainly due to lack of awareness by MFIs of the business potential of serving them.[21]

2. Achievements and outcomes

The initiative is ongoing, and no formal evaluation has been carried out so far. However, by the end of 2022 the three MFIs that received funding from GCAF have opened new branches in the districts of Moyo (Parlorinya camp), Yumbe (Bidibidi camp) and Isingiro (Nakivale camp) where many refugees live. There, VisionFund Uganda, a GCAF partner since 2020, was serving 28,739 active borrowers in the MFI branches managed under the programme (including 20% refugees and 72% women), for an outstanding loan portfolio of 3.3 UGX billion (EUR 868,663). In the MFI branches concerned, major digitization work has been carried out with 100% digital loan disbursements.

Despite various constraints and risks, in particular relating to the COVID-19 pandemic, GCAF considers that the program has developed well. A recent assessment found that out of a sample of 373 respondents, 91 new jobs had been created either through new businesses or through the expansion of existing businesses. Over 80% of the surveyed borrowers also reported that they had started saving. Similarly, 78% of the surveyed borrowers claimed that the knowledge and skills acquired during the trainings they attended contributed to the growth of their businesses.[22]

3. Challenges and lessons learned

Launching a successful refugee finance program is highly dependent on political support in the host county, which was the case in Uganda. Part of the reason therefore could possibly be that the refugees mainly coming from South Sudan belong to the same or closely related ethnic and language groups as people living in northern Uganda. A key for political and public support for the facility in Uganda was to also include members of the host population as potential MFI borrowers under the credit facility.

When discussions started between Sida, GCAF and UNHCR, the goal of the program was, in addition to Uganda, to simultaneously set up similar credit facilities in Jordan and Lebanon, serving Syrian refugees as well as host populations in both countries. In Lebanon there was no political support whatsoever to finance refugees and GCAF soon abandoned the idea for a credit facility in the country. In Jordan the political opposition

[21] https://www.unhcr.org/africa/media/sida-unhcr-and-grameen-credit-agricole-foundation-join-hands-promote-access-financial
[22] https://www.gca-foundation.org/en/media-room/#the-foundation-unhcr-and-sida-continue-to-join-forces-to-ensure-financial-inclusion-for-refugees-in-uganda

was not as pronounced, but in the end, at least until now, a similar credit program has not materialized in Jordan.

C. Parametric Volcano Bond

1. Overview of the initiative

The Danish Red Cross, partnering with Mitiga Solutions for risk modelling, Barcelona Supercomputing Centre for risk simulations, Replexus Partners (insurance brokers), Danish Ministry of Foreign Affairs, and the former UK Government's Department for International Development (DFID), sponsored, developed, and placed the first ever volcano parametric CAT bond through a private placement in the ILS market.

Ten volcanoes were selected for insurance coverage in partnership with RCRC NSs in Ecuador, Indonesia, Chile, Colombia, Guatemala, Mexico, and Cameroon.

Proximity to vulnerable populations was a key criterion in volcano selection. At least 700.000 people live within 100km of each of the volcanoes. A payout of the $3 million insurance policy will be triggered if a volcanic ash plume reaches a height of 12 kilometers at any of the ten volcanoes, and if the prevailing wind directs the resulting ash of such an eruption were to spread towards vulnerable communities.

The volcanic risk CAT bond was issued using a unique blockchain based platform as a way to bring down transaction costs.

The volcano bond has a three-year duration, from March 2021 to March 2024, and has a yield in the 5% p.a. range, which is low in comparison with other CAT bonds. The bond coupon is paid by the Danish Red Cross, with funds for innovative finance mechanisms like this one provided under the Danish Red Cross' Strategic Partnerships Agreement with the Danish Ministry of Foreign Affairs.[23]

2. Effectiveness and efficiency in disaster response

The effectiveness and value for money of the Volcano CAT bond is yet to be evaluated including if it addressed the underlying problem in an efficient way. In essence you need to assess and decide how valuable rapid access to funding is worth in an emergency situation and how much you are willing to pay for that.

3. Future prospects and scalability

One of the main advantages of using an ILS CAT bond structure is that it is a well-known and recognized product among institutional and other investors, which makes it easy to standardize and replicate and place on the ILS market.

[23] HIFHUB Volcanoes CAT bond 2-pager

On the other hand, a CAT bond yield, i.e., the cost of the insurance cover, is usually quite high. However, high cost might be justifiable for e.g., the Philippines for a typhoon CAT bond. The cost for a typhoon CAT bond in the Philippines is treated as a necessary ongoing national budget expense, as it covers a considerable downside risk for the country, as well as eliminating the need to keep emergency funding on standby. The typhoon CAT bond ensures that the Philippines has the necessary resources available in a disaster situation as it releases needed funds rapidly should a typhoon hit.

The same reasoning could be applicable to the RCRC movement, especially if CAT bonds were pooled and consolidated. The average cost of pooled and bundled RCRC CAT bonds should stand a reasonable chance to be lower than for induvial CAT bonds as the risk would be spread out over several insurance policies and diverse risks.

As already mentioned, a big issue with CAT bonds is defining the payout trigger and baseline. E.g., a volcano eruption might cause considerable destruction and require substantial amount of funding for emergency response without having reached the CAT bond trigger threshold.

D. Rapid Disbursing Debt Conversion Mechanism (RDDCM)

RDDCM is an alternative sovereign debt swap model developed by ICRC and partners to address RCRC funding needs. The RDDCM mechanism is similar to traditional sovereign for-doing-good debt swaps, as it involves bilateral sovereign debt cancellation in exchange for the debtor country using cancelled debt to fund a certain defined objective, in this case for humanitarian projects carried out by the respective RCRC NS in that country.

However, unlike conventional sovereign debt swaps with Paris Club creditor nations, RDDCM aims to streamline the transaction process to enable rapid release of local currency by the government in the affected country for humanitarian purposes. The RDDCM framework could potentially eliminate the need for complex structuring, negotiation, and execution periods associated with traditional sovereign debt swap schemes.

One of the main features of RDDCM is a standby procedure based on pre-defined triggers of when and how a participating creditor nation cancels part or all of its debt to a debtor nation, and the debtor nation releases corresponding funding in local currency to the local RCRC NS, should a humanitarian crisis or emergency occur. This feature may enable humanitarian aid funding to be efficiently and swiftly channeled to locally NS-led crisis responses.

RDDCM, by facilitating a single, local-currency cash transfer from the debtor country government to the respective NS, could possibly eliminate the requirement for bespoke debt instruments and documentation.

RDDCM is an innovative approach to some of the challenges around traditional debt swaps and debt-for-good swaps, in particular because the outstanding debt is not reduced but rather fully converted into local currency and transferred to the respective NS to fund humanitarian programs. RDDCM therefore has the possibility of not negatively affect a debtor country's credit rating, as the outstanding debt is paid in full.[24]

RDDCM is potentially replicable concept and could become an important RCRC funding source. Next step should be pilot case as a proof of concept.

IV. Policy and Institutional Considerations

A. RCRC movement

The RCRC brand is one of the most widely recognized brands in the world and could not only be used in a more efficient way to generate additional grants from non-traditional donors and contributors and the general public, but crucially also to bring credibility to, and thereby attracting investors to, SDG investment vehicles with humanitarian aspects as a main or one of several sub targets.

The RCRC movement should systematically liaise with fund managers in the SDG and ESG finance space to bring more attention to humanitarian aspects and proposing possible partnerships and RCRC sponsorship and branding of SDG finance vehicles. RCRC sponsorship of e.g., a climate adaptation investment fund may facilitate fund raising and reduce perceived risk for investors.

Although not directly related to innovative finance as such, the RCRC movement could play a leading part in e.g., the reconstruction and pos conflict investments in Ukraine, where the RCRC brand could lend credibility, for a fee, to pilot projects in e.g., health, water resource management and other water, sanitation, and hygiene (WASH) projects.

In general, the RCRC movement should take a more pronounced and leading role in intellectual and operational leadership in the HIF space and act as the main connector and convener of financial resources for humanitarian resources, as well as taking a more active role as project developer.

A potentially efficient way to promote humanitarian innovative finance as an integral part of SDG related finance structures, could be the development of a humanitarian investment taxonomy. E.g., a taxonomy for peace bonds is currently being developed with the goal of incorporating peace promoting aspects of SDG related bonds.[25] Similar taxonomy work could and should be done to incorporate humanitarian aid aspects in SDG related finance.

[24] https://shop.icrc.org/debt-conversion-for-humanitarian-and-climate-impact-pdf-en.html
[25] https://financeforpeace.org/

The RCRC movement has a unique capillarity and data collection capability. There is already a significant amount of data available that could be of great value for project development in the humanitarian space, but potentially a lot more data could be collected by the RCRC movement for project development purposes. The RCRC capillarity could also be used for Monitoring and Evaluation (M&E) purposes. Project developers and fund managers often lack adequate data for both project development and M&E, and the RCRC movement could become quite a valuable partner in this regard.

B. Regulatory and legal frameworks affecting humanitarian innovative finance

International sanctions imposed by the US and the European Union (EU) e.g., in Syria are not applicable for humanitarian aid provided by the RCRC movement. However, the sanctions make it virtually impossible for private sector actors to be present and invest in the countries in question. International sanctions therefore make structuring and implementation of HIF solutions unfeasible in affected countries. Countries listed and uncooperative jurisdictions by the EU are also much more complicated for institutional and impact investors domiciled in Europe to invest in.[26]

Institutional investors are also affected by laws and regulations in their countries of legal presence. E.g., in the EU, Solvency II is a regime for insurance and reinsurance undertakings, which limits the way insurance companies may invest assets in high risk or unrated investments. It is however up to each EU member state to interpret Solvency II and how it is implemented in each individual country and regulations are therefore not uniform throughout the EU.[27]

V. Conclusion

A. Summary of key findings and insights

Investing resources to promote HIF has potential to harness considerable additional resources for the RCRC movement, as well as to bring about cultural and behavioral change among stakeholders in the organization, creating an environment fostering innovation, and, in the end lead to a more efficient organization and to better overall humanitarian aid results and outcomes.

The increasing focus on the SDG agenda by state, civil society and private actors is fertile ground to promote and include humanitarian aid in SDG and ESG focused investment vehicles, frameworks, and funds. While this may not provide a comprehensive solution of the funding needs of the global humanitarian aid system, it stands a good chance to efficiently complement traditional grant funding and provide solutions to finance humanitarian aid, particularly in prolonged crises.

[26] https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/
[27] https://www.eiopa.europa.eu/browse/regulation-and-policy/solvency-ii_en

To capitalize on this opportunity, the RCRC movement needs to form new strategic alliances with state actors and other traditional donors, as well as institutional and impact investors. Intermediaries, such as advisory firms and fund managers, may also play a crucial role in bridging the gap between the RCRC movement and larger private investors. Developing a taxonomy for humanitarian innovative finance could be an efficient tool to promote and support this work.

The RCRC movement should therefore leverage internal and external experts, partner with experienced fund managers, and connect with institutional and impact investors as well as with potential local or regional investors in potential investment countries and regions.

Structuring humanitarian investment vehicles that are fit for purpose should be driven by an actual need rather than the other way around. It is quite easy to fall in the trap of creating a solution and then look for a problem that it may solve. Stakeholders in the RCRC movement should therefore clearly define the challenges and problems they aim to address and why an alternative investment approach is preferable to a traditional grant-funded one.

Incentivizing the sharing of knowledge and data between all humanitarian innovative finance stakeholders inside and outside the RCRC movement would contribute to enhance overall potential investor interest and could potentially increase the flow of capital for humanitarian impact. Sharing best practices, deal templates, terms, returns, and other resources in a transparent way internally within the RCRC movement but also with external actors could contribute to reducing investor risk perceptions and potentially eventually lower overall financial costs for HIF solutions.

HIF may play a major role in not only addressing the pre- and post-crisis phases in prolonged humanitarian crises, but also for rapid release of funding through insurance-based solutions for natural disasters.

B. Recommendations for RCRC policymakers, practitioners, and stakeholders

Promoting and integrating a HIF agenda may result in a range of benefits not only for the RCRC movement as a whole, but also for an individual NS, significantly enhancing operations and impact. The positive impact is however not limited to possible additional and complementary funding for humanitarian aid and projects, it may also bring about several other advantages such as,

1. Through HIF, RCRC may tap into new and diverse funding sources and organizations, thereby increasing financial resilience and reducing dependence on traditional state and philanthropic actors and possibly also reduce the need for constant grant fundraising.

2. A NS taking an active role in developing and implementing HIF solutions will require collaboration with various new and old partners and stakeholders,

including governments and other state actors, private sector entities and especially financial institutions and investors. This could lead to valuable new partnerships, not limited to HIF, that may expand the NS' reach and influence.

3. Innovative finance solutions often rely heavily on data analytics and technology to inform decision-making and project development. This may not only improve the precision of resource allocation and HIF outcomes, but may also provide valuable insights for optimizing NS operations. The RCRC movement has a particular advantage to implement data driven HIF solutions through its unique capillarity and reach.

4. Pursuing HIF solutions will challenge a NS to think creatively and outside the box. This mindset shift may foster a culture of innovation within the organization and spur development of novel approaches to addressing humanitarian issues and projects.

Implementing a HIF agenda will however demand a cultural change and it is not without risks and potential pitfalls. Some of the potential drawbacks may include,

1. Developing and implementing HIF solutions require significant upfront investment of time, money, and expertise. A NS might want to prioritize direct humanitarian aid provision, and diverting resources away from this core activity for HIF may have a negative impact on quality and impact.

2. Innovative finance solutions will involve venturing into mostly uncharted territory for a NS and outcomes are uncertain.

3. Implementing HIF solutions may demand specialized knowledge in areas such as finance, technology, and data analysis. If a NS lacks the required expertise, the learning curve could be steep and the resources needed to acquire the necessary skills might be substantial.

4. Pursuing HIF solutions may cause mission drift and divert focus and energy away from the core humanitarian mission. It could lead to a shift in priorities, with more attention being given to financial strategies rather than the people and communities in need.

5. HIF solutions may involve complex financial instruments and partnerships that might raise ethical concerns. For instance, impact investing could be seen by some as prioritizing financial returns over the true needs of beneficiaries.

6. Developing and implementing HIF solutions can be time-consuming and involves an opportunity cost. The time and effort spent on these initiatives could possibly be better utilized for other activities, such as program development, advocacy, or building strong relationships within the RCRC movement and with other partners.

7. All NS operate with limited resources, and investing in HIF solutions might not be feasible within current budget constraints.

8. Many innovative finance solutions involve intricate legal, regulatory, and operational frameworks. Navigating through these complexities might require significant efforts and expertise that the organization might not be equipped to handle.

9. While HIF could lead to long-term sustainability and broaden the funding base, the benefits might not be immediately tangible.

It is therefore important for a NS to keep in mind that investing time and resources in HIF has an uncertain risk/return scenario. If a NS were to invest time and resources to engage in promoting, structuring, and implementing HIF solutions, it may take a considerable amount of time before there are any concrete results.

In addition, it is quite uncertain and possibly even unlikely that the financial resources generated by an innovative finance solution developed by a particular NS will generate funding for that NS and its activities. Successful innovative finance solutions for humanitarian aid address a certain humanitarian need or a certain humanitarian objective and should be implemented by the most adequate and suitable RCRC actor, that may be the NS that developed the project, or not.

Consequently, in essence, it is important to keep in mind that for any NS investing in developing HIF solutions should be seen in a light of promoting and contributing to an overall increase of financing for humanitarian aid, and not as a way to contribute, at least not directly, to funding the ongoing and future engagements and projects of a particular NS.

That all being said, and it is important to keep in mind the potential risks and pitfalls listed above, there is an increasing interest and focus on innovative finance in the RCRC movement, not only a central level at ICRC and IFRC, but also in several RCRC NSs and actors, where HIFHUB at the Danish Red Cross is one of the most prominent RCRC actors focused on promoting HIF solutions.

HIF is an emerging and growing area within RCRC, and all interested NS investing time and resources in close collaboration with other interested NSs and ICRC and IFRC, could actively contribute to shaping and growing the emerging RCRC HIF agenda and opportunities.

References and Interviews

Specific references for a certain text segment can be found as footnotes throughout the document.

Interviews and discussions have been held with representatives of the following organizations:

Organization

Australian Red Cross

British Red Cross

Convergence

Danish Red Cross

Folksam

HIFHUB

ICRC

IFRC

IFRC Europe

Netherlands Red Cross

Rise

SEB

Sida

Spanish Red Cross

Swedish Red Cross

World Bank