THE AFRICAN INFRASTRUCTURE RISK AND RESILIENCE (AIRR) EVENT

Held on 27 October 2014 in Cape Town

Hosted by Santam Group, UNEP FI PSI and NBS-SA

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AFRICAN INFRASTRUCTURE AND RESILIENCE IN FOCUS

Santam co-hosted a day of expert dialogue and collaborative thinking in October 2014 at a Risk, Resilience and African Infrastructure workshop to unpack how integrated risk management can support successful project finance and insurance.

The day was a practically focused engagement with senior practitioners and experts from different disciplines such as project finance, insurance, investment, governance and academia. It combined knowledge sharing, small group dialogue and brainstorming sessions.

Santam frequently finds itself operating within systems that are creating infrastructure around Africa and convened this day of collaborative thinking in association with the United Nations Environmental Programme Finance Initiative's Principles for Sustainable Insurance (PSI) and the Network for Business Sustainability South Africa (NBS-SA).

It is widely understood that effective management of the risks associated with infrastructure projects in Africa is very complex, involving many fields of expertise and both long and short time frames. The best way to optimise a system for all participants is to bring the system together so that it can 'hear' itself to enable new relationships and for fresh, more comprehensive solutions to emerge.

The workshop was specifically focused on African infrastructure and most of the participants at the workshop were from African organisations, weighted towards South Africa.

Future African cities

As Africans we are the creators of our own infrastructure system and we are also the creators of our future African cities. The individuals in the room were all part of this system that facilitates the building of our infrastructure and future cities. Africa is faced with a massive infrastructure deficit and is vulnerable to risk. Whether it is roads, railway, airports, electricity or water and sanitation, these elements are severely lacking on the continent today and adversely impacts business and society.

Currently billions of dollars are flowing into the system to meet our growing needs. With this massive investment in infrastructure comes the responsibility to create and build sustainably. As Africa's growth is being fuelled by the promise of its potential, it begs the question if the stakeholders involved in individual projects are mindful of the broader risks and impacts.

These questions were central to the day and following the event, it was clear the stakeholders in the broader African project finance and infrastructure system were not fully aware of the broader perspectives on environmental, social and governance risks nor where different party needs well understood or visible.

The importance of recognising the potential impacts of risks and resilience at a systemic level (here used in the economic and socio-ecological sense) in building new infrastructure and cities was emphasised in the conversations and considered absent from current considerations in the transactional value chain. Two themes stood out from the day: risk management and systems thinking.

Speakers focused on how bringing the African infrastructure system together in a collaborative spirit can build increased resilience by becoming more aware of the complex risks they face both individually and collectively. In addition to bringing the stakeholders across the system together, we set out to share information from the academic sphere and the business sector to better understand the African context, presently and the forces shaping the future.

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Dr Anton Cartwright, Urban Futures Researcher from the African Centre for Cities at UCT, wrote a piece that was sent to all participants ahead of the event titled *African Infrastructure Resilience: Time for a New Perspective on Risk*. This piece described the context around the day and summarised the challenges we face while providing an introduction to the idea of shared value and is attached in the appendix. It highlighted the opportunity, i.e. "Africa Rising", noting that six of the 10 fastest growing countries between 2001 and 2010 have been from Africa and nine of the top 20 fastest economies in 2012 came from Africa. It is important to note that African economic growth is off a low base and that continental GDP is still less than that of the likes of Brazil and Russia. So although there are positive signs, we must not ignore the reality that Africa is fraught with environmental, social, governance and economic risks.

Prof. Ralph Hammann, UCT Graduate School of Business, shared the latest research from the NBS-SA (which can be accessed here *http://nbs.net/knowledge/stakeholder/social-capital/executive-report/* and *http://nbs.net/knowledge/strategy/strategic-planning/executive-report/*). He highlighted the need to consider how to deal with business conditions that are increasingly unpredictable and complex requiring the engagement of multiple stakeholders. He stated these conditions require transformative solutions and collaborative dialogue.

Insurance industry uniquely positioned

Butch Bacani, programme leader of the UNEP FI Principles for Sustainable Insurance Initiative (PSI), was one of the guest speakers. In his presentation he stated that the insurance industry is uniquely positioned to tackle environmental, social and governance risks and opportunities in a changing risk landscape.

The PSI Initiative is a global initiative to drive systemic change and its vision is of a risk-aware world, where the insurance industry is trusted and plays its full role in enabling a healthy, safe, resilient and sustainable society. Their purpose is to enable the global insurance industry to better understand, prevent and reduce environmental, social and governance risks, and better manage opportunities to provide quality and reliable risk protection.

Sustainable insurance is a strategic approach where all activities in the insurance value chain, including interactions with stakeholders, are done in a responsible and forward-looking way by identifying, assessing, managing and monitoring risks and opportunities associated with environmental, social and governance issues. The PSI set out creating a pioneering global framework and global initiative to drive systemic change. To date members represent 15% of world insurance premium and include Swiss Re, Munich Re, AXA, Allianz and IAG.

In an example of a company-wide approach in implementing the Principles, Butch shared news of the work Swiss Re's Sustainability Risk Framework is doing spanning industry sectors focusing on sensitive environmental, social and governance issues. In another example Munich Re is busy developing an underwriting tool to assess environmental, social and governance issues in engineering projects.

In a market-wide approach, and through the work of Brazilian PSI signatories and the Brazilian Insurance Confederation, the Brazilian insurance industry has set environmental, social and governance (ESG) goals for 2015.

They are busy monitoring implementation to achieve the following:

- 40% of insurers will integrate ESG criteria into their risk underwriting policy;
- 30% of insurers will have an ESG engagement programme targeted at brokers;
- 50% of the insurance industry will integrate official public policy of municipal, state and federal governments into their social responsibility policy; and
- 50% of insurers will report on ESG criteria.

Global sustainable development agenda

Butch also shared news of the global sustainable development agenda en route to 2015 and beyond through the PSI Global Resilience Project to build disaster-resilient communities and economies. He believes a skewed funding focus globally presents a case for action. According to Butch the project brings together insurers from around the world to deepen their understanding of disaster risk reduction, to assess the economic, social and environmental cost and to use this information to help governments and communities manage risk.

In 2013, 20 000 people were killed or went missing as a result of natural disasters. Global economic losses due to natural disasters amounted to USD131 billion, or almost 2% of GDP, but many nations spend more on disaster relief and recovery than on disaster risk reduction. Funds are diverted to dealing with disasters after the fact, rather than being spent on reducing the risk of disasters occurring.

Butch shared the findings from the Global Resilience Project (*http://www.unepfi.org/fileadmin/documents/building_disaster-resilient_communities_economies_01.pdf*) which showed that more pro-active investment in disaster risk reduction could lead to:

- Less economic, social and environmental losses;
- Safer and more disaster-resilient communities and economies;
- Less public and private funds spent on disaster relief and recovery, enabling better investment;
- More access to affordable insurance to help communities manage the uncertainty of adversity and the financial hardship associated with unexpected losses.

Insurance Australia Group has taken the lead on the project as the Australian government invests $50 million each year in disaster risk reduction, but more than $560 million in post-disaster relief and recovery. For every $10 spent on post-disaster relief and recovery, only $1 is spent on disaster risk reduction.

In December 2012, Insurance Australia Group (IAG) initiated the formation of the Australian Business Roundtable for Disaster Resilience and Safer Communities, and in September this year the Australian government's Productivity Commission released a draft report recognising the inequality of current natural disaster funding arrangements.

The Commission is now recommending that the Australian government increase its state funding for disaster risk reduction to $200 million.

Butch says they are encouraged by this development and ultimately will focus on efforts to replicate what's happening in Australia around the globe.

Meaningful workshop

Santam values these learning dialogues as it enables participants to share their experiences and practices as financiers, insurers and specialists. The broader systems perspective is crucial in order to see and understand the implications of decisions. This will ensure that we are not unintentionally and unknowingly, as a system taken together, increasing risk and reducing resilience on the ground through our individual transactional decisions thus creating an undesirable future infrastructure for ourselves.

We are thankful to delegates for their commitment to the workshop and we encouraged all participants to reflect on the various discussions for their perspective as to what it means for their respective organisations. Our hope is that participants will reflect on the workshop and suggestions made by participants to consider what would be worthwhile and possible to do next that can create pre-competitive shared value for participants in African infrastructure project finance and insurance. Even though the quality and range of the discussions were excellent, there is a lot more that could be unearthed and thought through around the question: 'How do we finance and build properly resilient infrastructure in Africa?

What the event proved is that business people from different, but mutually dependant sectors do not normally engage in an open manner about African infrastructure projects, yet they greatly value the opportunity to do so. The space that we convened is the first of its kind in the African infrastructure and project finance sector and judging from the reactions of the participants there is definitely a need for more engagement and dialogue events of its kind.

Feedback from participants and facilitators

We received mainly positive feedback from delegates, with the participants clearly enjoying the day and engaging energetically with the content and dialogues.

From their responses we noted the following feedback, observations and suggestions in particular:

- That in future versions of the workshop it may be helpful to include more case studies that are specifically around the topic of infrastructure and project finance.
- The experience of collaborative dialogue was really appreciated, some participants suggested the future potential and benefits of collaborative action to reduce risk and increase the resilience of project finance and infrastructure decisions.
- The day helped strengthen the understanding and awareness of the nature of the project finance and infrastructure value chain. By bringing the different parts of the sectors together it showed that the system itself is not fully understood or visible to participants in it.
- The social imperative in Africa is very important and infrastructure plays a significant role in addressing the social disparities that currently exist. The different stakeholders in the room recognised that they each have a role to play, individually and collectively.
- There is a lack of pre-competitive collaboration in the project finance sector. This is natural because of competition and protection of intellectual property. Because there are natural impediments to knowledge sharing, collaboration is difficult. But, it is clear there will be mutual benefit through risk being priced accurately and actions taken to mitigate certain risks. It is hoped that the current and future PSI and other sectoral projects will support sensible collaboration and the setting of good ESG (environmental, social and governance) practice for increased resilience.
- The accurate pricing of risk was a recurrent topic; also highlighting the short timeframes available for risk assessment by insurers in the project finance and infrastructure value chain. Questions raised included the timing of insurance underwriting, how the financial sector and project finance partners could synergise on risk assessments for mutual and broader systemic benefit and what the challenges/frictions are that prevent the exchange of information for increased resilience and shared value.

APPENDIX

African infrastructure resilience

Time for a new perspective on risk?

Food for thought in preparation for the AIRR Workshop

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This note outlines a fresh perspective on the risks of financing and insuring infrastructure in Africa, the continent on which the global dilemma of how to advance decent living standards in the face of resource scarcity, climate change and weak governance is playing out most acutely. The intention is to enable a meaningful conversation amongst delegates at the AIR workshop. The note draws on Michael Porter's notion of "shared value" and Umair Haque's idea of "thick value", but explores how corporate leaders can give these business management concepts meaning, focussing on the risks associated with both insurable and un-insurable assets while delivering Africa's much needed infrastructure.

The context is the "Africa Rising" narrative first coined by the Economist in 2011. That storyline tells us that six of the fastest growing economies in the world between 2001 and 2010 were in Africa; in 2012 the continent boasted 11 of the 20 fastest growing economies; growth is not only attributed to commodities, but is being driven by private sector investment in telecoms and transport infrastructure and the retail and banking sectors. It is a compelling story from the continent that has long served as the emblem of obdurate poverty and humanitarian crises. Clearly, Africa is beginning to offer new opportunities and anybody interested in owning, financing and insuring infrastructure needs to pay attention.

Africa's economic rise presents a rare and important opportunity. Whether they intend to or not, financial flows into Africa will shape the continent's future. For the sake of Africa's people and the success of businesses looking for a sustained presence, it is imperative that investors and insurers recognise the continent's specific set of circumstances. Such investors will look behind the headlines and observe that the remarkable economic growth has been restricted to certain African countries, off a very low base, and that the entire continent's GDP remains less than that of either Brazil or Russia. Perhaps most critically, income per capita has remained almost stagnant and while the increasing numbers of people living in African cities are better off than those in rural areas, Africa's massive urbanization is not providing the broad economic stimulus that defined previous urbanization waves in Europe, North America and parts of the Asian continent.

Delivering service and transport infrastructure to the majority of Africa's residents is a development priority that is estimated to require between $68bn and $93bn per annum over the next three decades (World Bank, 20081). It is not yet clear how this money will be raised. Low per capita income and the relatively small size of many African cities (less than 500,000 people) preclude conventional "user- pays" public finance models for the building of public infrastructure (Foster, V (2008) Overhauling the Engine of Growth: infrastructure in Africa. Africa Infrastructure Country Diagnostic, World Bank). In the absence of fiscal resources, the infrastructure that is being built is private sector financed and fashioned around consumption patterns of a small (often politically connected) urban elite. In many instances the building of this infrastructure takes full advantage of inadequate governance, accountability and land tenure arrangements at the local level.

Obvious examples include Eko Atlantic off Lagos, roads and railway infrastructure built exclusively for mines and the plethora of mega-shopping complexes and gated communities that are now a feature of all large African cities. Such developments are the product of "finance as usual" but in the context of African cities they transfer risk to the poor, undermine the prospect of governance, aggravate inequality and drive splinters through urban spatial plans, tearing up the social fabric that is essential to decent urban living in the process.

If this is to be the nature of finance and infrastructure in the "Africa Rising" era, most of Africa's growing urban population will continue to confront economic and environmental crises without the benefit of formal housing, centrally co-ordinated water, sanitation and energy and while relying on informal employment. Those crises are expected to be severe. We know that crises place a disproportionate burden on the poor, and if Africa's development deficit continues people living in the continent's cities will not only be punished by crises, but informal urban communities will also amplify the risk of crises and foment new crises of their own. In an increasingly interconnected world it will prove very difficult to insure against the ensuing risks, or to insulate clients from those risks.

Global warming provides a good example. By 2050 mean atmospheric temperatures in Africa will almost certainly be at least 2°C above the long-term average and perturbed climates are already exposing social and institutional fault lines, affecting the availability of food and water and the prevalence of disease in Africa's informal settlements. A 2012 UNICEF report claims that 99% of deaths attributed to climate change have occurred in developing countries and that 80% of those were children. Ironically, global concern about climate change will also truncate Africa's development options by restricting access to the cheap fossil energy and mobility that were central to the earlier industrial development of OECD countries. The inevitable outcome is a new set of social and economic risks, many of which will weigh heavily on companies and insurers.

Risk is something that the readers of this note know a lot about, but managing systemic risk in Africa's cities requires much more than an actuarial recalibration or an increment on premiums for insurable assets. Perhaps the greatest risk associated with Africa's next wave of infrastructure is not that projects will lag delivery schedules, run over budget or be poorly maintained, but rather that a series of piece-meal contracts, each "successfully" completed, will create dysfunctional urban systems. Cities built in this way will be predisposed to fail. They will fail (1) socially – through exclusion, transfer of risk to the uninsured, conflict and crime, (2) environmentally – through water pollution, flooding and carbon intensity, and (3) financially – due to their maintenance cost and inability to catalyse higher earnings amongst the population and broad economic growth. In their failing they will compound existing risks and generate risks of their own. Crucially, these types of risk will be embedded in the bricks and mortar of long-lived infrastructure and very difficult to change. They would constitute a future burden for asset owners, financiers and insurers and cause a progressive haemorrhaging of economic opportunities in Africa's urban centres.

History suggests that, unless there is a deliberate effort to adopt a systems perspective and to build system health, that short term incentives (often with noble intentions) can unwittingly generate precisely this type of unintended systemic risk. Two examples, one from nature and one from society, serve as illustrative examples:

- For the North American bull elk, reproductive success is determined by antler size. Genetic mutations that provide bigger antlers tend to be passed on, due to the competitive mating process. Over time bull Elk antlers have become obscenely large, causing individual animals loss of mobility. In regions where wolf populations have been restored, bulk Elk immobility has caused elk populations to be decimated. As a species, bulk elk would be better off if each animal had smaller antlers and was more mobile, but the rules of their reproductive success do not allow this.
- A more familiar example of the same dynamic is provided by national security and the global arms race. Competing against enemy countries requires increasing investment in armaments, so as to dissuade attack or ensure success in the event of an attack. But all countries know this and acquire armaments commensurate with their enemies'. The net result is no relative advantage, but a considerable waste of investment. Each country would be better off spending its money on things other than arms, but in the absence of an international disarmament agreement this does not happen.

In both examples a short-term perspective presents the allure of an advantage or benefit for individual players, but in ignoring the system on which they ultimately depend the outcome is always self-defeating. How to prevent this type of perverse incentive is a central focus of the AIR workshop, with the understanding that financing, insurance and building African infrastructure will only be economically valuable if it can look beyond individual assets and instead contribute towards inclusive and flourishing built environment.

The required approaches will involve public goods at the local scale, but local authorities are unlikely to be of great assistance when it comes to marshalling a fiscus or crowding in private sector investment. Similarly, the UNFCCC's Green Climate Fund, intended to provide $100bn per year, will play a role post-2020 but will also be hampered by the need to convene a political consensus and raise capital. Private sector investors, then, may be called upon to adopt a long-term, pro-poor focus and to invest in both public and private goods. This approach will be unfamiliar and will almost certainly seem unattractive to traditional analyses. New perspectives on investment mandates, employee incentives and shareholder interests may be required. The types of risk in question are complex, not easily quantified or placed into probability distribution curves, but they are none the less urgent, a matter of life and death for a great number of people in this generation. For this reason they are of huge economic and business consequence.

The cost of responding to humanitarian crises in Africa has trebled in the past decade, and the economic impact of the crises goes far beyond the cost of response.

Solutions have to be found, but the precedents for quick wins are scarce and should be treated with caution. What we can learn from the available evidence is the value of working with local communities; strengthening - not displacing - local risk mitigation measures; mobilising local resources (including local finance); enfranchising women in decision making and learning; the deliberate creation of new jobs in the reduction of environmental risk and in creating virtuous cycles of social, ecological and financial capital in concert; and putting a price on CO2 so as to harness its value and change behaviour. But these are tentative features of success and do not offer blue-prints.

The challenge is to generate sufficient consensus as to what a desirable future looks like, and then to devise insurance and investment packages that embody these features and work towards that future. As with the arms race, the systemic nature of the risks ensures that no single company can contemplate success on its own. Opportunists and free-riders should be anticipated and countered with a critical mass of action working in concert so as to create virtuous cycles of development for African cities. Along the way the required collaboration needs to pass muster with anti-trust authorities.

Generating a strategic coalition and critical mass begins with frank, intellectually generous discussion between the key players. The unprecedented nature of the challenge ensures that there are no experts, but the magnitude of the risks outlined above needs to remain foremost in our minds if the intuitively compelling business jargon of "thick" and "shared" value is to find an application in the context of Africa's cities.

This is why the opportunity for key stakeholders to dialogue on the 27th of October is potentially so valuable.