<table>
<thead>
<tr>
<th><strong>Project Name</strong></th>
<th>South East Europe and Caucasus Catastrophe Risk Insurance Facility</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Region</strong></td>
<td>EUROPE AND CENTRAL ASIA</td>
</tr>
<tr>
<td><strong>Country</strong></td>
<td>Armenia, Bosnia and Herzegovina, Georgia, Macedonia, Serbia</td>
</tr>
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<td><strong>Sector</strong></td>
<td>Non-compulsory pensions, insurance and contractual savings (70%); General water, sanitation and flood protection sector (30%)</td>
</tr>
<tr>
<td><strong>Lending Instrument</strong></td>
<td>APL</td>
</tr>
<tr>
<td><strong>Project ID</strong></td>
<td>P110910</td>
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<tr>
<td><strong>Borrower(s)</strong></td>
<td>Armenia, Bosnia and Herzegovina, Georgia, Macedonia, and Serbia</td>
</tr>
<tr>
<td><strong>Implementing Agency</strong></td>
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</tr>
<tr>
<td><strong>Environmental Screening Category</strong></td>
<td>{ }A { }B (X)C { }FI</td>
</tr>
<tr>
<td><strong>Date PID Prepared</strong></td>
<td>October 12, 2010</td>
</tr>
<tr>
<td><strong>Estimated Date of Appraisal Completion</strong></td>
<td>September 30, 2010</td>
</tr>
<tr>
<td><strong>Estimated Date of Board Approval</strong></td>
<td>February 15, 2011</td>
</tr>
<tr>
<td><strong>Decision</strong></td>
<td>Project authorized to proceed to negotiations upon agreement on any pending conditions and/or assessments.</td>
</tr>
<tr>
<td><strong>Other Decision [Optional]</strong></td>
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I. Country Context

*Countries of South East Europe and the Caucasus (SEEC) are highly vulnerable to natural hazards.* Ninety percent of the area of South East Europe is located within trans-boundary river basins, which makes the region highly prone to floods. Due to climate change, the frequency and severity of natural disasters, particularly those of hydro-meteorological origin, are rising in all SEEC countries. In addition, the Balkans and the Caucasus, located on the intersection of two continental plates, have suffered some of the most damaging earthquakes in the recent past and remain highly vulnerable to both small and large quakes.
Natural disasters in the Europe and Central Asia (ECA) Region exact severe human, physical and economic losses to both governments and populations – particularly the poor. The financial crisis has already weakened many national economies and threatened livelihoods, making the population and the states even more vulnerable to the effects of natural disasters. Globally, economic losses from climate-related and geological perils are rising, averaging US$100 billion per annum over the last decade. Only in the first six months of 2010, the economic losses caused by natural disasters amounted to US$72 billion. In addition to the economic toll, natural disasters have been the source of death, disability, and loss of physical and productive assets.

Adopting regional approach is an effective way of disaster risk mitigation. Natural disasters do not respect national borders, which makes regional cooperation and risk pooling crucial for disaster risk management. The Southeastern Europe Disaster Risk Mitigation and Adaptation Program (SEE DRMAP) and Central Asia and Caucasus Disaster Risk Management Initiative (CAC DRMI), joint initiatives comprising analytical and advisory activities of the World Bank and the United Nations International Strategy for Disaster Reduction (UNISDR), identified areas that are important for reducing disaster risk in the region over the coming years. One of these areas is the creation of the disaster risk financing and hedging instruments through financial risk pooling and market-based risk transfer mechanisms.

II. Sectoral and Institutional Context

Governments in the region have extremely limited financial capacity to assist their populations in regaining assets and productive capacity destroyed by natural disasters. The 1979 Serbia earthquake caused damage worth 366 times the amount allocated by the government for emergencies. The 1994 Macedonia floods caused damage worth 77 times the amount allocated by the government. In Armenia, 20 years after the Spitak earthquake, due to the lack of financial resources over 6,000 of the displaced population are still living in temporary housing. For this reason, one of the basic tenets of disaster risk mitigation is the transfer of the financial risks of disasters from the public to the private sector.

Catastrophe insurance and weather risk coverage among homeowners, small- and medium-size enterprises (SMEs) and farmers is currently almost non-existent in the region (only 1-2 houses out of 100 currently have private catastrophe insurance coverage). Consumers often do not understand the need for such insurance, believing that the government or donations will cover their losses in case of a natural disaster. Local insurers have been reluctant to offer catastrophe insurance since the risk is not well diversified on an individual country level, reinsurance for catastrophe risks is not readily available at a price supported by the local market, and risk management requirements for catastrophe risk are complex and often well beyond the technical capabilities of local insurers. Therefore, the catastrophe insurance products that do exist are usually restricted only to selected clients as companies ration the availability of catastrophe coverage through higher prices or simply decline to cover weather and earthquake related risks.

1 See Financial Times, July 8th, 2010.
2 Mitigating the Adverse Financial Effects of Natural Hazards on the Economies of South Eastern Europe. A Study of Disaster Risk Financing Options; Eugene Gurenko and Wael Zakout; World Bank/UN ISDR; 2008
Catastrophe risk insurance is one of the pillars of the Bank Group’s Disaster Risk Mitigation Strategy. The Kyoto Protocol, the UN Framework Convention on Climate Change and the Bali Action Plan all call for risk sharing and transfer mechanisms such as insurance as a means of protecting populations from the adverse effects of climate change. By means of transferring the financial and fiscal risk of disasters from government to the private sector, countries can protect the national economy, homeowners and SMEs, as well as achieve more effective targeting of post disaster government assistance. All of these capabilities become increasingly important in the environment of global fiscal tightening.

Relying on 12 years of global experience in designing national and regional catastrophe risk insurance programs, the World Bank, jointly with its regional partners, the Regional Cooperation Council and the UN ISDR, is now addressing the problem of low catastrophe insurance penetration in South East Europe and the Caucasus through the creation of the regional Catastrophe Risk Insurance Facility (SEEC CRIF), which has been recently incorporated as “Europa Reinsurance Facility Ltd” (Europa Re).

Design of the Catastrophe Risk Insurance Facility began in the countries of South East Europe in March, 2008. It closely follows the previous prototypes of national and regional catastrophe risk programs developed with the direct technical and capital assistance from the Bank – the Turkish Catastrophe Insurance Pool, the Romanian Catastrophe Insurance Pool and the Caribbean Catastrophe Risk Insurance Facility. However, Europa Re contains several new innovations. These include (i) the development of both traditional indemnity type catastrophe insurance products and parametric index-based weather risk hedging contracts; (ii) private management and governance of the facility; (iii) a sunset clause for the duration of government participation in the program; and (iv) the openness of the Facility to a wider range of clients, inclusive of government agencies and businesses exposed to weather risk.

Europa Re is designed as a regional reinsurance pool that will benefit from economies of scale, regional risk diversification, and the state-of-the art risk management capabilities that will consequently translate into lower premium rates prices for weather risk and catastrophe insurance products in SEEC countries. Specifically, risk modeling and development of catastrophe risk insurance products is time-consuming and expensive; individual countries present relatively small markets with little premium volume and undiversified risks, which makes them unattractive to reinsurers. By pooling the risks and resources across a larger region: (a) investments in insurance risk modeling become more effective; (b) there is a larger potential market for catastrophe insurance products; (c) the risks are diversified, making the provision of such products both less expensive for consumers and more attractive to insurers; and (d) insurance policies can more easily be packaged for coverage by the global reinsurance market. In addition, this approach mirrors the trans-boundary character of most natural disasters, which often affect a number of neighboring countries.

III. Project Development Objectives

The Project Development Objective (PDO) is to increase access of homeowners’, businesses and government agencies to financial protection from losses caused by climate change and geo-

3 Further on throughout the document the names SEEC CRIF and Europa Re will be used interchangeably.
hazards. The PDO will be achieved through supporting the creation of Europa Re – a specialized regional reinsurer-which in turn will enable a rapid growth of catastrophe risk insurance markets in the member countries.

IV. Project Description

Insurance coverage against weather risk and geo-related perils in the countries of South East Europe and Caucasus is virtually non-existent. Europa Re is a catastrophe risk re-insurance company owned by countries of South East Europe and Caucasus with the objective to increase the number of homeowners, farmers, SMEs and government organizations insured against weather-related risks and geo-hazards.

Europa Re will enable businesses, households and governments better adapt to climate change by receiving access to affordable and accessible insurance coverage against weather extremes and geo-hazards. The main insurance products backed by Europa Re will be: (i) parametric index-based weather insurance coverage for climate-related hazards such as excessive temperature or precipitation, which would protect the buyers against the loss of business revenue due to adverse weather; and (ii) catastrophe insurance coverage for damages caused to property and contents by earthquake and flood. A detailed list of the perils to be reinsured by Europa Re and the list of catastrophe insurance instruments that would be supported through the facility’s pricing and underwriting web-based platform is presented in Annex 1. All catastrophe insurance products will be sold through local private insurance companies and their agents and reinsured by Europa Re.

The proposed project comprises the following two components:

- **Component 1: Participation in Europa Re.** The project will support SEEC countries’ efforts to join Europa Re by financing their shareholder contributions to the Facility. This component is proposed to be financed by IBRD financing (for Serbia and FYR Macedonia) and IDA funding (for Armenia, Georgia, and possibly Bosnia and Herzegovina).

- **Component 2: Technical assistance.** While the project will not directly finance any technical assistance work required for the launch of the facility, it will (i) enable Europa Re to procure the necessary technical expertise out of its own funds; and (ii) play a catalytic role in raising donor funding for the technical work required for the launch of new catastrophe insurance products in the member states.

V. Financing

<table>
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<tr>
<th>Source</th>
<th>($m.)</th>
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<td>Borrower/Recipient</td>
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<tr>
<td>IBRD</td>
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<tr>
<td>IDA</td>
<td>15.0</td>
</tr>
<tr>
<td>Others (specify)</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>25.0</strong></td>
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</table>
VI. Implementation

Project Ownership and Exit Strategy. At the initial stage, the Facility will be owned and governed by member countries, due to the critical importance of governments in creating and supporting the demand for catastrophe insurance among homeowners and SMEs. However, the government shareholders will be expected to sell up to 30 percent of their shares in 3 years from the commencement of Europa Re operations and up to 100 percent of shares within 5 years to private investors.

Project Implementation Agency. Europa Re will act as the project implementation agency and the main Bank counterpart for the purposes of project implementation. To this effect, it will rely on its own personnel and the professional staff of the Management Company, which it will retain through a tender. All costs of the management services and hence of project implementation will be borne by Europa Re and funded out its own capital or donor funds.

Management Company. Europa Re will be managed by a competitively-selected, special purpose, privately-owned insurance services firm that will provide underwriting, pricing and risk management services. The management company will also place reinsurance on behalf of the facility and, if necessary, will enter into alternative risk financing arrangement with risk capital providers. The company’s management will be expected to put in additional equity, either in the form of an up-front monetary contribution, or through "sweat equity" by providing management services at below cost. This will constitute a performance incentive to ensure the success of the managed entity and will considerably reduce the fixed management costs.

Regulation. Europa Re will be domiciled and regulated in Switzerland which has a highly advanced and sound insurance regulatory regime. Besides the minimum capital requirements obligated by Solvency I, as of 2011 the company will comply with risk-based solvency requirements prescribed by the Swiss Solvency Test.

Governance Structure. To ensure that the management of Europa Re is immune from potential political pressures that may adversely affect its operational and financial performance, there is a clear separation of the company’s business operations from the government ownership of the Facility. To this effect, Europa Re has retained an independent professional board of directors consisting of reputable insurance/reinsurance professionals with a well-established track record in the industry. Overall strategic oversight and policy advice will remain with the company's shareholders (the Ministries of Finance of the member countries) and will be exercised through the Annual Meetings of Shareholders and the Advisory Policy Board.

Role of Governments. The member states will play a fundamental part in ensuring Europa Re’s success by providing the financing for the Facility as well as participating in its governance through the shareholders meetings and in the policy advisory board. The member states will also extend all necessary logistical and technical support to the various consultants entrusted with the country risk assessments so as to ensure expeditious and effective completion of these studies. Although the expected government policy support for the program may vary from country to country, it is likely to include the following actions:
Creating the enabling regulatory and legal framework for the operations of Europa Re, including the enactment of risk-based supervision for catastrophe insurance risk;

Carrying out extensive public information and awareness campaigns about the availability and benefits of catastrophe insurance products;

Implementing policies that will encourage sound disaster risk management practices by homeowners and companies, including linking mortgages in disaster prone areas to catastrophe insurance and limiting post-disaster aid to a defined amount or a fraction of the insured limit; and

Insuring government owned housing stock against the risk of natural disasters;

The minimal policy and regulatory standards expected to be introduced in the participating countries may include but not be limited to: (i) compulsory insurance for all mortgage borrowers residing in disaster prone areas; (ii) requirement of proof for catastrophe insurance coverage on all properties in disaster prone areas upon registration of real estate sales; and (iii) mandatory insurance of government-owned housing stock; and (iv) adoption of risk-based supervision for catastrophe risk written by insurers in member states. The project team is currently working with the government of Albania, the first country to join the facility, to develop a model set of minimum regulatory and policy requirements to be implemented by every country member of the facility.

**Role of Private Sector in Participating Countries.** Locally licensed private insurance companies in participating countries will issue catastrophe insurance policies to homeowners, farmers and SMEs, and will settle claims. Claims from weather-related events covered under parametric weather risk contracts will be settled automatically by the Facility. To transfer catastrophe insurance risk assumed in the process of selling these products, primary insurers will then enter into a reinsurance contract with *Europa Re*, which will cover a major part of the risk under these insurance policies. Reinsurance coverage will be provided automatically for all insurance policies issued by insurers in accordance with the recommended risk underwriting and pricing guidelines of the Facility and administered through a web-based underwriting platform. Local insurers will be compensated by receiving insurance commissions for their distribution and claims settlement fees. In addition, those insurers who will choose to retain a part of risk under the catastrophe risk policies reinsured with *Europa Re* will also receive a part of risk premium.
VII. Safeguard Policies (including public consultation)

<table>
<thead>
<tr>
<th>Safeguard Policies Triggered by the Project</th>
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<tr>
<td>Environmental Assessment (OP/BP 4.01)</td>
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<td>Natural Habitats (OP/BP 4.04)</td>
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<td>Projects in Disputed Areas (OP/BP 7.60)</td>
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<tr>
<td>Projects on International Waterways (OP/BP 7.50)</td>
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</table>

VIII. Contact point at World Bank and Borrower

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* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas
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