

# DEBT CONVERSION FOR HUMANITARIAN AND CLIMATE IMPACT



# EXECUTIVE SUMMARY

People affected by armed conflict and other violence continue to face devastating humanitarian consequences, with the climate crisis compounding risks and heightening vulnerabilities. Restricted aid budgets, and the increase in climate-related humanitarian emergencies, call for new approaches that allow local leadership to build affected people's resilience and increase their capacity to anticipate and respond to crises.

Funding humanitarian aid through bilateral debt cancellation is nothing new. However, conventional "debt-for-do-good swap"<sup>1</sup> arrangements tend to be cumbersome and time-consuming, often with long structuring, negotiation and execution periods, in comparison to the relatively modest size of the proceeds they generate from the perspective of the sovereign parties involved.<sup>2</sup> The International Committee of the Red Cross (ICRC), together with partners from the International Red Cross and Red Crescent Movement, has developed a financing model known as the Rapid Disbursing Debt Conversion Mechanism (RDDCM, or the Mechanism). With a streamlined transaction structure, this model aims to address these problems by facilitating the rapid release of local currency<sup>3</sup> in the affected country, in order to mobilize resources for National Red Cross and Red Crescent Societies (National Societies) and provide critical assistance to affected populations.

The Mechanism allows the debtor country and the bilateral creditor to agree for the former to discharge a portion of its foreign currency-denominated loan to fund a critical humanitarian project carried out by the National Society in the country. Since it involves a single, local-currency cash transfer from the authorities in the debtor country to the National Society, the Mechanism does not – unlike conventional structures – require the issuance or transfer of debt instruments, the opening of securities accounts or multiple money transfers. Moreover, thanks to the Standby procedure, which can be used to pre-arrange the activation of the RDDCM in anticipation of a humanitarian crisis or emergency, the Mechanism offers an innovative alternative for channelling climate and humanitarian funding to a locally led crisis response, including in conflict settings that are typically deprived of other forms of climate finance.

The ICRC and its partners hope that the bilateral creditors of countries facing critical humanitarian crises, which are increasingly exacerbated by climate change, will seriously consider providing assistance through this streamlined Mechanism. In order to support an effective roll-out, interested creditors, prospective debtor countries and humanitarian actors should consider the following recommendations:

## CREDITORS

- Adopt a pre-emptive approach.
- Strengthen coordination across different government departments and bodies on identifying thematic and regional priorities.
- Contribute to the financing of a technical assistance pool in order to strengthen local capacities.

## DEBTORS

- Strengthen partnerships with local humanitarian actors and facilitate access to ministries relevant for the programmatic aspects of the Mechanism.
- Monitor debt instruments and allow for swift identification of the appropriate debt instruments.

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1 Sovereign debt relief transactions that involve the funding of humanitarian or development programmes in exchange for debt forgiveness, including debt-for-nature arrangements that have increasingly been used to finance conservation and environmental programmes.

2 From a local humanitarian perspective, the size of the transaction may not be considered modest.

3 Following the stakeholder outreach and negotiation phases, and once the bilateral creditor and the local authorities have their internal approvals in hand and the Debt Conversion Agreement is signed, the Mechanism, with its single, local-currency disbursement, can be deployed in a matter of days if needed to fund urgent humanitarian activities in the debtor country.



## HUMANITARIAN ACTORS

- Increase cooperation by leveraging pre-existing capacity-strengthening initiatives, and provide new technical assistance where these do not already exist.
- Ensure that climate risk is integrated into the design of humanitarian programmes, including population resilience-building activities, while also building the expertise of the National Society.<sup>4</sup>

As well as fleshing out these recommendations and providing further details about the Mechanism and its advantages, this paper outlines two examples of humanitarian programmes that could potentially be funded through RDDCM proceeds: a more rapid response in Malawi, where millions of people still need humanitarian assistance in the aftermath of the cholera outbreak and Cyclone Freddy, and a longer-term nature-based adaptation programme in two counties of Kenya that are particularly prone to hazards and disasters, with floods alternating with drought.



<sup>4</sup> The RDDCM currently foresees the involvement of components of the International Red Cross and Red Crescent Movement but its adoption could be extended to a broader set of humanitarian actors.

# 1. GLOBAL HUMANITARIAN CONTEXT

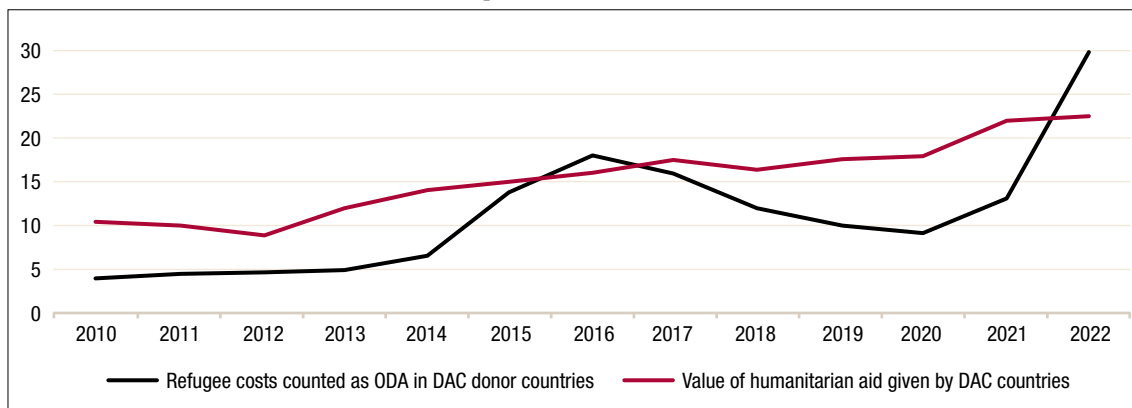
## 1.1 GROWING HUMANITARIAN NEEDS AND CONSTRAINED BUDGETS CALL FOR NEW APPROACHES

The growing risk of conflict and other violence is making affected people increasingly vulnerable. **In 2023, over 339 million people are estimated to need humanitarian assistance and protection, up by 23 per cent compared to 2022.**<sup>5</sup> Behind this headline figure lie a number of worrying trends:

- **Food insecurity is rising:** in 2023, around 222 million people are estimated to face acute food insecurity.
- **Forced displacement is also on the increase:** a record 103 million people were estimated to be displaced as of mid-2022, including 53 million internally displaced people (IDPs).
- **Public health is deteriorating:** alongside an increasing mortality rate, infant vaccine coverage has experienced its biggest drop in 30 years.

**Many of today's conflicts are protracted and some are marked by growing hostilities that leave large numbers of people needing help. At the same time, acute crises are occurring increasingly frequently.** The international armed conflict between the Russian Federation and Ukraine is producing global spill-over effects, triggering or exacerbating economic, social, food and energy insecurity, particularly in low-income countries (LICs). These challenges, in addition to the pressure exerted by the climate crisis, call for both short-term emergency actions and medium- to long-term responses, further underscoring the importance of building emergency preparedness and response capacities while preserving the agility to deliver longer-term activities.

Figure 1. Humanitarian expenses for in-country refugees vs foreign humanitarian aid across OECD DAC countries (in USD million, 2021 prices)



Source: OECD

In this context, international humanitarian assistance has almost doubled in volume in the past decade,<sup>6</sup> while foreign aid from the world's largest donor governments increased to an estimated 204 billion US dollars in 2022.<sup>7</sup> However, once again, behind these headline figures lie worrying trends: in 2022, Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) members spent more on financing in-country refugee costs – which represented 14 per cent of reported official development assistance (ODA) – than on actual foreign humanitarian aid (see Figure 1).

<sup>5</sup> United Nations Office for the Coordination of Humanitarian Affairs (OCHA), *Global Humanitarian Overview 2023*, OHCA, New York, 2022.

<sup>6</sup> ALNAP, *The State of the Humanitarian System: 2022 edition*, ALNAP, London, 2022.

<sup>7</sup> As measured by official development assistance (ODA) from members of the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC).

In addition, 8 per cent of ODA was spent on bilateral aid to Ukraine,<sup>8</sup> resulting in falling resources for other crises in LICs and the **highest humanitarian financing gap ever recorded**, at USD 22 billion.<sup>9</sup>

**With climate-related humanitarian emergencies expected to increase in frequency and scale, it is critical to develop new, locally led partnerships and financing models in order to respond to these crises and to build resilience to climate change.**

## 1.2 CLIMATE EMERGENCIES CAN EXACERBATE TENSIONS AND LEAD TO DISPLACEMENT IN CONFLICT-AFFECTED AND FRAGILE CONTEXTS

**The most severe impacts of climate change are not necessarily felt in the places with the greatest exposure, but instead in places where people’s capacities to cope have already been curtailed by conflict and fragility.**<sup>10</sup> Violence forces people to focus on immediate survival, significantly reducing their ability to adapt to longer-term climate stresses.<sup>11</sup> As most of the 25 states deemed most vulnerable and least ready to adapt to climate change are affected by armed conflict, the humanitarian system has a vital role to play in addressing these compounding vulnerabilities.<sup>12</sup> People’s experience of climate change and conflict cannot be treated in isolation, particularly as the Intergovernmental Panel on Climate Change’s 2022 AR6 report shows that more acute heatwaves, droughts and floods are already exposing millions of people to food and water insecurity.

**In conflict settings, climate change acts as a “threat multiplier”.**<sup>13</sup> While climate change does not directly cause conflict, competition over access to natural resources often fuels intercommunity tensions and gives rise to or exacerbates violence. Moreover, conflict damages institutions, the economy, services, infrastructure, social cohesion and governance – the very things that people rely on to cope with and adapt to shocks. In turn, climate shocks can compound this damage and leave even more people needing help. And conflict itself can also harm the environment, contributing to cycles of increased vulnerability and putting people at further risk.

**Despite their high vulnerability, people living in conflict-affected contexts are largely excluded from climate finance.** Although donor governments and international financial institutions have committed to finding ways to channel funding for loss and damage and adaptation to conflict-affected situations, climate finance institutions remain risk-averse, avoiding contested territories that are not under state control. Even in stable contexts, public climate finance operates under rigid bureaucracies with strict fiduciary requirements and elaborate application procedures that often exclude local actors.<sup>14</sup> As conflict-affected states often lack institutions that can apply for and manage significant sums of climate finance, there are large gaps in risk management and risk transfer. **In order to build people’s resilience and adaptability, a continuum of responses is required**, including adaptation programmes and preventive action – such as investing in disaster risk reduction, early warning systems and anticipatory action<sup>15</sup> – on top of conventional shock response and recovery action.

<sup>8</sup> I. Loy, “Why foreign aid isn’t as generous as the latest figures might suggest”, *The New Humanitarian*, 13 April 2023.

<sup>9</sup> Global Humanitarian Overview of United Nations agencies unmet requirements: <https://fts.unocha.org/appeals/overview/2022>, accessed 12 May 2023.

<sup>10</sup> K. Peters *et al.*, *Double vulnerability: The humanitarian implications of intersecting climate and conflict risk*, ODI working paper 550, Overseas Development Institute (ODI), London, 2019.

<sup>11</sup> W.N. Adger *et al.*, “Human Security”, in Y.O. Estrada *et al.* (eds), *Climate Change 2014: Impacts, Adaptation and Vulnerability. Part A: Global and Sectoral Aspects. Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*. Cambridge University Press, Cambridge, 2014.

<sup>12</sup> As defined by the NS-GAIN Country Index: <https://gain-new.crc.nd.edu/ranking/vulnerability>, accessed 28 April 2023.

<sup>13</sup> K. Peters *et al.*, 2019.

<sup>14</sup> ICRC *et al.*, *Embracing Discomfort: A Call to Enable Finance for Climate-Change Adaptation in Conflict Settings*, ICRC *et al.*, London, 2022.

<sup>15</sup> Anticipatory action is a set of actions taken to prevent or mitigate potential disaster impacts before a shock or before acute impacts are felt. Based on a forecast and risk analysis, the IFRC agrees to fund National Societies for early action in advance of a predicted hazard. Money is automatically released once a forecast threshold or “trigger” is met. This is one tool that National Societies already use to lessen the impacts of climate-related shocks for vulnerable communities.

### GROWING FOOD INSECURITY IN THE SAHEL

In the Sahel region of Africa, the humanitarian situation continues to worsen under the effects of protracted armed conflict and other violence. The severe climate crisis affecting the region – characterized by recurrent droughts and floods – has caused arable land, water and other resources to become increasingly scarce. In addition to competition over these natural resources, clashes have destroyed or restricted people’s access to agricultural and pastoral land. In combination, these factors have led to poorer harvests and a shortage of feed and pasture for livestock herders.

The ICRC, working alongside National Red Cross and Red Crescent Societies (National Societies), helps residents, returnees, displaced people and other at-risk households to recover from the combined consequences of conflict and the climate crisis and to build their resilience. In terms of the short-term response, the ICRC distributes food and essential household items. Where markets are functioning, the organization provides cash or vouchers, and assists people in producing their own food and in pursuing income-generating activities. It provides support to households directly and/or to local authorities and service providers, in the form of seed, tools, animal feed, training, and vouchers for fodder, livestock vaccination and other animal-health services.

In Niger, more than 2 million people are food-insecure, internally displaced people depend mostly on humanitarian aid for survival, and rural communities essentially rely on pastoralism and farming. In 2023, the ICRC and the Red Cross Society of Niger launched the first “**Ecoresilience**” project. What makes this programme innovative is the implementation of such an approach in a conflict-affected context. As well as addressing the short-term needs of displaced and host communities, the programme aims to anticipate and adapt to the existing and expected disruptive effects of climate change. The activities, which are identified in discussion with affected communities, include water-control structures to prevent soil erosion and flooding, soil rehabilitation and regeneration, the establishment of climate-resistant community seed banks, and agro-sylvo-pastoral integration to develop sustainable income strategies.

## 1.3 CAPACITY-STRENGTHENING AND FINANCIAL PARTNERSHIP WITH LOCAL HUMANITARIAN ACTORS FOR LONG-TERM SUSTAINABILITY

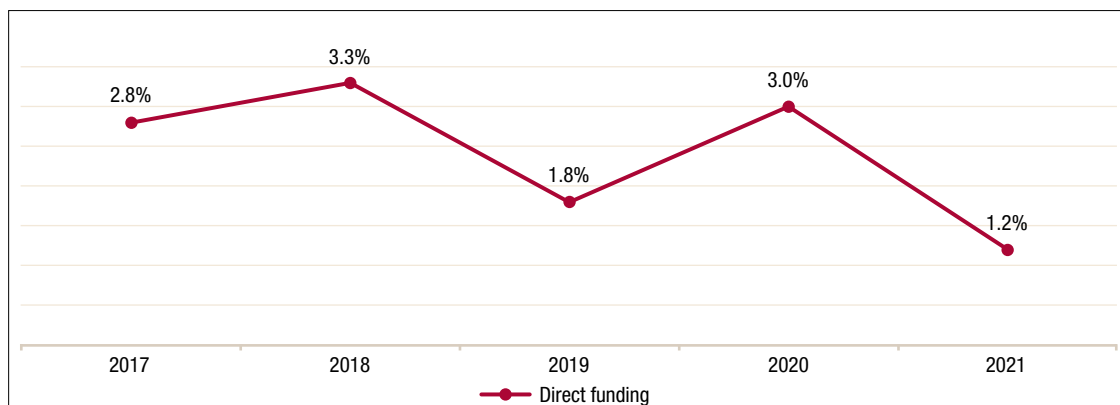
National and local entities – including authorities, civil society and non-governmental actors – are often the first to respond to humanitarian crises. They remain in the communities they serve before, during and after an emergency. In many contexts, **local humanitarian action is often timelier, more cost-effective and more efficient**, since local actors possess the knowledge, networks, and political and cultural awareness to assist vulnerable communities.<sup>16</sup>

Following the 2016 World Humanitarian Summit, **a platform bringing together humanitarian organizations and donors** started to work on the **Grand Bargain** to tackle system-wide financing challenges and the localization agenda. The Grand Bargain signatories are committed to “making principled humanitarian action as local as possible and as international as necessary”, recognizing that international humanitarian actors play a vital role, particularly in situations of armed conflict. Pledges made by aid organizations and donors within this framework include increasing and supporting multi-year investment in the institutional capacities of local and national responders, and working to remove or reduce barriers that prevent organizations and donors from partnering with these responders.

<sup>16</sup> European Commission, “Localisation: factsheet”: [https://civil-protection-humanitarian-aid.ec.europa.eu/what/humanitarian-aid/localisation\\_en](https://civil-protection-humanitarian-aid.ec.europa.eu/what/humanitarian-aid/localisation_en), accessed 28 April 2023; C.C. Venton *et al.*, *Passing the Buck: The Economics of Localizing International Assistance*, Share Trust and Warande Advisory Centre, Dover, Massachusetts, 2022.

The original Grand Bargain framework included a commitment to achieve, by 2020, a target of at least 25 per cent of humanitarian funding to local and national actors as directly as possible to improve outcomes for affected people and to reduce transactional costs. To date, **this commitment is proving challenging to meet**, with direct funding to local and national actors remaining well below 5 per cent in recent years.<sup>17</sup>

Figure 2. Direct funding to local and national actors (% of the total)

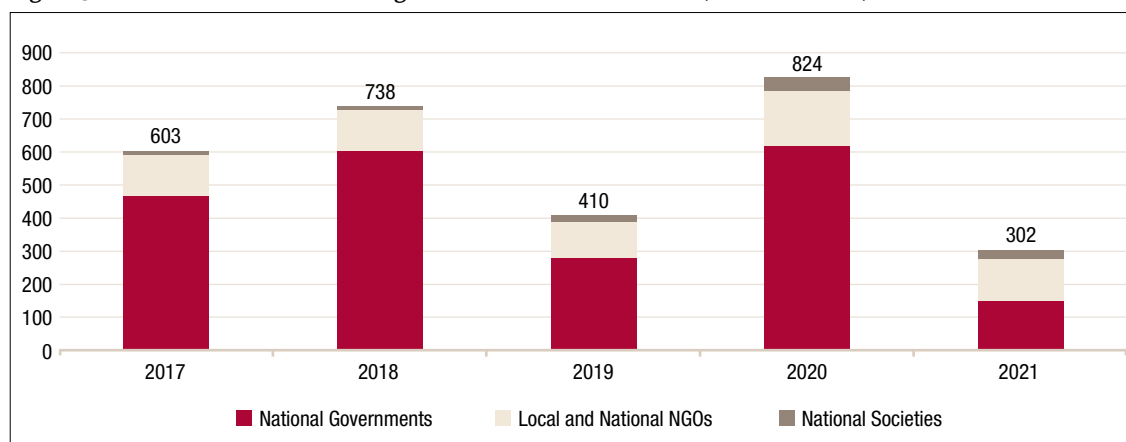


Source: Development Initiatives, based on data from the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) Financial Tracking Service (FTS)

## 1.4 THE INTERNATIONAL RED CROSS AND RED CRESCENT MOVEMENT

The International Red Cross and Red Crescent Movement (the Movement) is a global humanitarian network of 80 million people that helps those facing disaster, conflict, and health and social problems. It consists of the International Committee of the Red Cross (ICRC), the International Federation of Red Cross and Red Crescent Societies (IFRC) and 192 National Societies. The National Societies operate neutrally and independently from the IFRC and the ICRC but are bound by the Movement’s Statutes and Fundamental Principles, with the **goal of assisting and protecting victims of humanitarian crises in an impartial manner**.

Figure 3. Direct humanitarian funding to local and national actors (in USD million)



Source: Development Initiatives, The Global Humanitarian Assistance Report 2022 (based on OCHA FTS data)

17 More details, including the list of the Grand Bargain signatories, can be found on the Inter-Agency Standing Committee website: <https://interagencystandingcommittee.org/content/grand-bargain-hosted-iasc>, accessed 28 April 2023.



**As part of the national crisis response structure, National Societies receive a small share of the direct funding to local and national actors**, as illustrated in Figure 3 below. Although they are private and independent organizations, National Societies have a recognized public function given their auxiliary role of supporting the public authorities through humanitarian services in times of war or peace.

**The ICRC views cooperation with National Societies as fundamental to fulfilling its own mandate and to accomplishing the Movement's mission.** The ICRC and National Societies have therefore developed long-standing partnerships in order to prepare for humanitarian emergencies, and to ensure a concerted, efficient and rapid humanitarian response to armed conflict or other violence.<sup>18</sup>

**National Societies are in a unique position to link humanitarian and climate work** because they already work across the climate and disaster-risk continuum. They have a mandate to further disaster preparedness in different capacities, to help disseminate early warnings, to support disaster-risk management efforts through national and international projects, to pioneer anticipatory-action approaches in which protective measures are taken in advance of a pending disaster, and to support humanitarian response and recovery. This role can be strengthened and aligned with national climate goals, particularly in supporting climate-resilient recovery or furthering anticipatory action.

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<sup>18</sup> Operational cooperation covers various activities, such as providing first aid and health care, distributing food and providing other forms of humanitarian assistance, and restoring family links. In line with its mandate, the ICRC cooperates with National Societies to support their development and to provide a more relevant and sustainable humanitarian response.



## 2. THE MECHANISM

### 2.1 ORIGINS

**Funding humanitarian aid and similar projects through bilateral debt cancellation is nothing new: many countries have participated in these transactions over the past 40 years.** Historically, however, **conventional “debt-for-do-good swap” arrangements, including “debt-for-nature” arrangements, have suffered from several drawbacks.** The transactions have tended to be cumbersome and time-consuming. They have usually involved multiple transfers or the amendment of debt instruments, with all the associated legal and transactional costs. And the structuring, negotiation and execution of these transactions has often required an amount of effort that is disproportionate in comparison to the relatively modest proceeds they generate.<sup>19</sup> Moreover, authorities in many developing countries are particularly concerned about the credit-rating implications of any transaction that involves debt “cancellation”, even if modest in size and praiseworthy in purpose.<sup>20</sup>

**The ICRC, together with Movement partners, has designed and developed a financing model known as the Rapid Disbursing Debt Conversion Mechanism (RDDCM, or the Mechanism). With a streamlined and efficient transaction structure, this model aims to address these problems** by facilitating the rapid release of local currency in the affected country, in order to mobilize resources for National Societies and provide critical assistance to affected populations.

### 2.2 HOW IT WORKS

**The Mechanism is designed to permit local-currency funding of humanitarian projects through the conversion of a portion of the Host Country’s<sup>21</sup> external debt.** It involves the following steps:<sup>22</sup>

- A. The National Society and the ICRC identify a humanitarian project (the Project) requiring local-currency funding and prepare a description and proposed budget for that Project.
- B. The ICRC solicits the interest of one or more bilateral creditors of the Host Country in funding the Project and concurrently obtains the approval of the local financial authorities for the operation.
- C. The bilateral creditor writes down on its books an agreed portion of a foreign-currency loan to the Host Country.
- D. The financial authorities in the Host Country (typically, the central bank or the ministry of finance) transfer an agreed amount of local currency to a bank account held by the National Society.
- E. With the ICRC’s technical assistance, the National Society draws down from that bank account to fund and implement the approved project.
- F. The bilateral creditor, the ICRC and the local authorities each receive regular and comprehensive reports on how the funds have been used. The bilateral creditor also has the option of visiting the project site and monitoring progress.

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<sup>19</sup> From a local humanitarian perspective, the size of the transaction may not be considered modest.

<sup>20</sup> Concerns about credit ratings induced a number of International Development Association countries to decline the debt-service deferments offered under the Debt Service Suspension Initiative in 2020–2021.

<sup>21</sup> The Host Country is used in the prepared forms of legal documentation, referring to the debtor country.

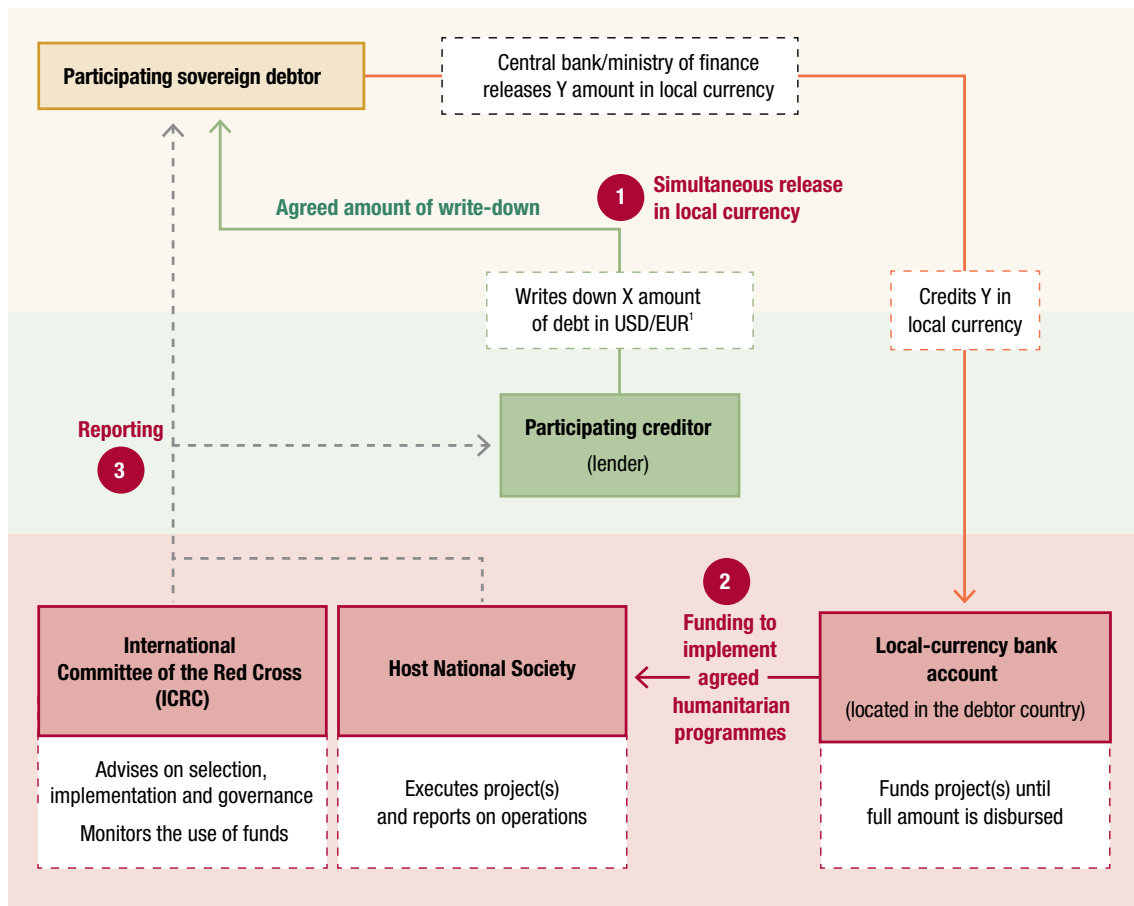
<sup>22</sup> Depending on the context, the ICRC’s technical assistance role described above can be fulfilled by other Movement components; see Section 2.4 for more details. Steps C onward occur following the signature of the Debt Conversion Agreement.

In effect, the Mechanism allows the debtor country and the bilateral creditor to agree for the former to discharge a portion of its foreign currency-denominated loan to fund a critical humanitarian project carried out by the National Society in the country, with technical assistance from Movement partners as needed.<sup>23</sup>

Because the Mechanism allows the sovereign borrower to discharge a portion of its existing external debt in local currency and does not involve an outright forgiveness of that liability, **the transaction should not be construed as a debt restructuring** or a signal of a broader sovereign financial distress.

**The relatively modest amounts involved in these operations<sup>24</sup> should not result in any significant inflationary pressure, while the fact that the funds are held in a local bank account will attenuate the effect of the money being released into the local economy. Once the bilateral creditor and the local authorities have their internal approvals in hand and the Debt Conversion Agreement is signed, the Mechanism can be deployed in a matter of days if needed to fund urgent humanitarian activities in the Host Country.**

Figure 4. How the RDDCM works



Note 1: Agreed amount of foreign currency-denominated debt write-down and release in local currency occur simultaneously

Source: ICRC

<sup>23</sup> The Mechanism should be implemented in accordance with the Fundamental Principles of the Movement, its Statutes and the Code for Good Partnership, not affecting the ability of Movement components to carry out their humanitarian activities in a neutral, independent and impartial manner.

<sup>24</sup> For the first pilot transactions, the size and duration of the humanitarian project should not exceed the equivalent of USD 10 million and five years respectively.

## 2.2.1 STANDBY MEMORANDUM OF UNDERSTANDING

**In order to further expedite the mobilization of local-currency funding for essential humanitarian programmes in the Host Country, the ICRC has prepared a form of Standby Memorandum of Understanding (MoU) that can be used, in advance, to pre-arrange the paperwork and procedures for activation of the Mechanism in the event of an Extraordinary Circumstance.<sup>25</sup> All parties will expressly understand and acknowledge, however, that the **signing of the MoU does not commit them to participating in a specific humanitarian relief effort in the future. Each party retains complete discretion over whether to join such an effort and, if so, on what terms.****

### Standby procedure

The Standby procedure works as follows:

1. If an Extraordinary Circumstance requiring prompt humanitarian action occurs in the Host Country after the date on which an MoU is fully signed, and if the relevant Movement partner determines that it is in a position to provide humanitarian relief to the victims of that Extraordinary Circumstance, the ICRC<sup>26</sup> contacts each of the signatories, as soon as practicable, to inform them of that determination.
2. The ICRC and the National Society then work as swiftly as possible to prepare a work programme and draft budget for the proposed Project, highlighting, in particular, the local-currency component of the draft budget for that Project.
3. The ICRC promptly circulates the work programme and draft budget to each signatory of the MoU and asks whether that party would be interested in utilizing the Mechanism to help fund the local-currency component of the draft budget.
4. If each party expresses its willingness, in principle, to participate in the funding of the identified Project, the ICRC solicits from each signatory any proposed amendments to, or comments on, the work programme and draft budget. In particular, the ICRC solicits:
  - from the bilateral creditor, the amount (in foreign currency) that it would be prepared to write down from one or more of its outstanding loans to the Host Country in return for the Host Country releasing an agreed amount of local currency to fund the Project
  - from the Host Country, the amount (in local currency) that it would be prepared to release to fund the Project in return for that write-down.
5. The ICRC circulates to all signatories an execution version of the Debt Conversion Agreement, which documents any agreed funding for the Project and is amended as necessary with the consent of all the parties.

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<sup>25</sup> An Extraordinary Circumstance is defined as a sudden event that causes a humanitarian crisis or emergency. In agreement with all parties, it can be more strictly defined, focusing for instance on specific hazards (climate-related physical events or trends that may cause damage and loss).

<sup>26</sup> The ICRC's role mentioned under the Standby procedure could, depending on the context, also be played by another Movement component.

### 3. ADVANTAGES OVER CONVENTIONAL DEBT SWAPS AND PUBLIC CLIMATE FINANCE

Conventional “debt-for-do-good swap” structures often involve a sale agreement with the seller of the instrument, an agreement between the non-governmental organization (NGO) and the local financial authorities regarding the redemption of the instruments, and multiple security and money transfer orders.<sup>27</sup>

**In contrast, the streamlined structure of the Mechanism presents the following advantages:**

- It requires no transfer, issuance or amendment of existing or new debt instruments.
- It is completely flexible: the amount of the bilateral debt conversion is agreed between the creditor and the authorities in the Host Country and does not need to cover the entirety of any particular loan.
- It requires only one money transfer: the Host Country authorities credit the amount to the National Society’s bank account in local currency, therefore avoiding fund transfer fees and eliminating the need to open securities accounts.
- It permits the use of exceptionally streamlined legal documentation (a draft of which has already been prepared) and therefore should not entail significant legal costs for any party.
- It provides all parties with full transparency and monitoring of the use of proceeds.

Importantly, **the Mechanism provides a new solution for climate finance.** Conventional humanitarian finance is too often constrained for local actors to address peoples’ vulnerability to climate stresses. The Mechanism, however, helps these actors to better integrate climate and disaster risk into their work, in both conflict-affected and more stable contexts, as it offers the following advantages:

- **Predictability:** National Societies can plan investments in preparedness, early action and climate-resilient recovery based on the pre-arranged procedures following the signing of the MoU. For National Societies with pre-existing climate-risk programmes including anticipatory action, MoUs could link payments to reliable forecasts.

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<sup>27</sup> A conventional “debt-for-do-good swap” arrangement using a bilateral debt instrument often involves the following steps:

- A. A bilateral creditor agrees to cancel one or more of its credit instruments (or a portion of it) in favour of the beneficiary country.
- B. The beneficiary country continues to pay, in local currency (or in the currency of denomination of the original contract), a portion of the cancelled instrument to a fund usually (but not always) located in the beneficiary country following a pre-agreed repayment schedule (often corresponding to the original repayment schedule).
- C. The proceeds are then used to finance investments identified by the national development strategy of the beneficiary country, with the technical assistance of the creditor country’s authorities (e.g. the development agency or the ministry of foreign affairs).
- D. Management of the proceeds is overseen by a binational committee composed of institutional representatives from the creditor and debtor countries.
- E. The binational committee sets the investment priorities, decides on the projects to be financed, supervises the use of proceeds and monitors the programme.

A conventional “debt-for-do-good swap” arrangement using a commercial debt instrument tend to be even more time-intensive to structure, often involving the following steps:

- A. The NGO must first identify a seller of the sovereign’s debt instrument and negotiate a discounted price.
- B. The NGO must raise the foreign-currency cash needed to buy the paper.
- C. If it does not already have one, the NGO must open a securities account at Euroclear or Clearstream.
- D. The NGO pays the cash purchase price to the seller and the seller transfers the instrument to the NGO’s Euroclear or Clearstream account.
- E. The NGO negotiates, with the authorities in the debtor country, the nature and amount of the consideration that would be paid for the instrument.
- F. The NGO transfers the instrument to the debtor’s account.
- G. The sovereign debtor notifies the fiscal agent or trustee of the cancellation of the instrument.
- H. Finally, the sovereign transfers the agreed consideration to the NGO.



- **Flexibility:** the Mechanism does not constrain the scope of activities included in the humanitarian programme, these being either pre-arranged in advance following the signing of the MoU, or directly defined with the Debt Conversion Agreement.
- **Speed:** the funds are disbursed quickly enough to reach communities in their time of need. Should parties favour a strongly pre-emptive approach and define the Extraordinary Circumstance as the occurrence of an early warning, the Mechanism can be activated once the early warning has been triggered. With a single money transfer in local currency, the Mechanism has a particular advantage over other climate finance mechanisms that pass through multiple intermediaries.

As National Societies further develop their capacities to address climate- and conflict-induced vulnerabilities, they will become more prepared for the recurring and severe climate emergencies that will define the coming decades. As such, broad participation in the RDDCM may in turn reduce the need for international humanitarian support as local actors will be better able to manage and respond to climate stresses.

**The Mechanism also offers specific advantages for each party to the transaction.** These are detailed in the subsections below.

## 3.1 ADVANTAGES FOR THE PARTICIPATING CREDITOR(S)

### STREAMLINED STRUCTURING AND MONITORING

**Given that the Mechanism involves a single and simultaneous release of local-currency funding by the Host Country authorities, creditors participating in the Mechanism no longer need to monitor a future repayment schedule.** As the humanitarian project is identified and agreed in advance, and as implementation and reporting are carried out by the National Society with the technical assistance of the ICRC (or of other Movement components as required), there is no need to set up a binational committee to select, fund and monitor the projects.

### ABILITY TO FUND PRE-IDENTIFIED HUMANITARIAN PROGRAMMES

**Creditors participating in the Mechanism can plan their support for future, pre-identified humanitarian emergencies via the Standby MoU.** Pre-identified humanitarian funding tends to make humanitarian assistance more efficient.<sup>28</sup> As such, the amount of foreign-currency debt written off by the bilateral creditor can have a stronger humanitarian impact when humanitarian actors are able to plan and coordinate their response to future Extraordinary Circumstances.

### SMALLER BUDGETARY IMPACT THAN A GRANT

Although budgetary practices differ across jurisdictions, the ICRC understands that the negative budgetary impact of writing off a loan is often spread across the remaining lifetime of the original instrument. In other words, the cancellation of a loan with an outstanding amount of 100 units, with annual repayments of 20 units over the next five years, has a negative budgetary impact of 20 units in each year until maturity. Using a standard discount rate of 5 per cent, the net present value (NPV) impact of these five successive negative budgetary entries would be equivalent to a discounted impact of 86.6 units today. This is less than the negative budgetary impact of a grant of a nominal amount of 100 units disbursed at inception. **Accordingly, from a creditor's budgetary point of view, cancelling an outstanding debt instrument via the Mechanism has a lower impact, in NPV terms, than providing an equivalent grant.**

<sup>28</sup> Development Initiatives and Norwegian Refugee Council, Field perspectives on multi-year humanitarian funding and planning, Development Initiatives, Bristol, 2019.

## 3.2 ADVANTAGES FOR THE PARTICIPATING DEBTOR

### STRONGER LOCAL HUMANITARIAN CAPACITY, INCLUDING TO BUILD CLIMATE RESILIENCE

**By participating in the Mechanism, a debtor country can channel local-currency funding to humanitarian actors implementing pre-agreed programmes.** During the negotiation phase, the debtor country can ensure that these programmes are in line with its development priorities. Meanwhile, the principles of impartiality and neutrality that govern National Societies and the ICRC ensure that humanitarian needs are independently reviewed. Given the auxiliary role of National Societies in supporting or standing in for the public authorities in the delivery of humanitarian services, the Mechanism offers an opportunity to strengthen critical facilities typically run by National Societies, as well as to develop their capacities to address climate- and conflict-induced vulnerabilities, thus contributing to national climate goals. **The humanitarian programmes financed by the Mechanism will therefore ultimately help build the debtor country's resilience** to future emergencies and support the establishment of infrastructure and services that benefit the population.

### REDUCED EXTERNAL DEBT AND SUPPORTED LOCAL CURRENCY

From a financial standpoint, the main objective of the debt conversion is to re-channel the debt service that a debtor country owes to one of its creditors towards domestic humanitarian programmes. **The Mechanism therefore brings an obvious financial advantage to the debtor country, which can re-allocate resources to fund local humanitarian activities, with direct benefits for affected people. Moreover, the Mechanism helps reduce the external debt stock of the debtor country, thus preserving its foreign currency stock while simultaneously supporting the adoption of local currency.**

## 3.3 ADVANTAGES FOR HUMANITARIAN ACTORS

**For humanitarian actors, the Mechanism provides access to additional resources, as well as an opportunity to create or deepen direct partnerships with bilateral creditors' authorities. Over time, it could also help strengthen local or national actors' capacity to plan and manage their humanitarian and climate-risk programming.**

**Within the Movement, the Mechanism offers National Societies a further opportunity to plan disaster-risk reduction and climate-change adaptation activities into their humanitarian support.** This could entail using climate forecasts to enable early action, reducing the carbon footprint of the emergency response, or supporting climate-resilient recovery by rebuilding in ways that address and mitigate local communities' core vulnerabilities to climate change. Many National Societies already undertake these types of activities using project-based methods in non-emergency contexts. For those without prior experience of addressing climate risk, the Mechanism could serve as an entry point to begin building expertise on integrating climate science and climate-vulnerability analysis into their humanitarian work. While the first series of debt conversions under the Mechanism are expected to result in modest funding relative to the budget of international aid programmes, local-currency funding equivalent to up to USD 10 million per conversion represents a significant financial resource for National Societies, with a meaningful impact on relief activities and outreach to vulnerable people. And as local capacities are strengthened, debt conversion volume could in turn be increased, further building the resilience of local communities.

The Standby procedure, pre-arranged legal documentation and operational processes have several advantages. As well as speeding up the negotiations between the parties involved in the debt conversion, they will allow **National Societies and other Movement components to prepare to implement humanitarian programmes and, therefore, get help to the people who need it in an efficient, transparent and predictable manner.** This is a key opportunity to integrate climate-sensitive conflict programming into their work – an area that has been largely neglected in the humanitarian sphere.<sup>29</sup>

<sup>29</sup> ICRC et al., 2022.

Concretely, **the proceeds from the debt conversion can also be used to help strengthen National Societies' capacity through programmatic and financial support from technical assistance partners, as agreed by all parties to the Debt Conversion Agreement.** While the details of the arrangement and the desired support will differ from country to country, National Societies could call upon these partners as needed, drawing on expertise from across the Movement and building on existing in-country capacity-development initiatives. With the possibility of embedding enhanced capacity through participation in the Mechanism, the National Society can replicate or scale up similar programmes in the future, with less upfront capacity investment.

#### EXAMPLES OF HUMANITARIAN PROGRAMMES THAT COULD BE FINANCED BY THE MECHANISM

**The Mechanism does not apply solely to contexts affected by armed conflict and other violence where the ICRC is active, since it channels funding towards critical humanitarian programmes implemented by the host National Society.** In countries where the ICRC is present, it will typically provide the National Society with technical assistance in planning, implementing, monitoring and reporting on the Project. But this could equally be done together with other Movement partners present in the Host Country. **Similarly, in countries that are not affected by armed conflict and other violence but where large numbers of people are in need of help, the Mechanism can be implemented with technical assistance from the host National Society's Movement partners, building on pre-existing assistance facilities as a priority.**

In terms of programmatic focus, **two types of humanitarian programmes could be financed via the Mechanism:**

- Short- to medium-term responses to specific emergencies
- Medium- to long-term humanitarian responses addressing structural issues in the Host Country.

Climate considerations can be integrated into both types of humanitarian programmes, though there is more scope for working across the disaster-risk spectrum in a medium- to long-term response.

The following examples illustrate two types of response.<sup>30</sup> Given its flexibility, the Mechanism can – subject agreement between the parties – include humanitarian programmes covering a wide range of alternative National Society activities.

#### **Example 1: Emergency response to the cholera outbreak and Cyclone Freddy in Malawi**

With life expectancy and health-care coverage well below the global average, Malawi faces significant challenges. This situation has been compounded by multiple public-health emergencies in recent years: the COVID-19 pandemic, polio, and several cholera outbreaks. According to the United Nations, since early 2022, **Malawi has been in the grip of the deadliest cholera epidemic in its history**, with more than 1,600 deaths and 51,000 infections recorded. To make matters worse, in March 2023, the country's **Southern Region was hit by Cyclone Freddy, which brought heavy and persistent rainfall** resulting in massive loss of lives and property. **The president declared state of disaster in the Southern Region, and several NGOs have stepped up efforts to provide urgent support to the population.** The Malawi Red Cross Society, working in partnership with the IFRC and the Danish Red Cross (its in-country partner), has been scaling up its cholera response, as well as its emergency cyclone response, bringing assistance to more than 2 million people. **To scale up the Movement response, the following five key activities could be funded by proceeds from the Mechanism:**

- Activity 1: Facilitate risk communication and community engagement at household and community levels.
- Activity 2: Build the capacities of volunteers and health-care workers and deploy them to support community mobilization and surveillance.

<sup>30</sup> More details of these humanitarian programmes are available on request.

- Activity 3: Provide critical cholera prevention and control supplies to support the district health office response.
- Activity 4: Support the implementation of the oral cholera vaccination campaign.
- Activity 5: Support the set-up and operation of oral rehydration points and cholera treatment centres.

**Similarly to the cholera emergency, the RDDCM proceeds could fund humanitarian aid to support the victims of Cyclone Freddy, with activities including risk communication and community engagement, surveillance and response, logistics and operational support, cash provision, and coordination and audit.**

**Example 2: Building community resilience and recovery through nature-based solutions and climate-smart strategies in the counties of Kilifi and Tana River, Kenya**

Food security, livelihood and environmental conservation activities are essential components of sustainable development and key to climate-change mitigation in Kenya, especially in the country's arid and semi-arid lands. Since 2011, the Kenya Red Cross Society has been implementing resilience and recovery activities at community level in the counties of Kilifi and Tana River in a bid to **address the current drought disaster and frequent, cyclical and multiple hazards including floods**. Lessons on nature, human and biodiversity challenges have been learned through community engagement and accountability, advocacy and disaster-risk reduction and, most recently, a climate-smart agriculture (CSA) project implemented in Tana River County.

**The proceeds from the Mechanism could be used to implement a programme targeting the following results:**

- **Result 1: Ecosystem restoration (human and biodiversity)**
  - Riverbank protection
  - Community tree planting and afforestation
  - School-based and youth nursery and tree planting
  - Rangeland management
  - Establishment of woodlots
- **Result 2: Resilience-building**
  - Agroforestry (support in materials and inputs, capacity-building)
  - Irrigation and rainfed farming (support in materials and inputs, capacity-building)
  - Beekeeping (support in materials and inputs, capacity-building)
  - Linkages to microfinance institutions, and establishment of Village Savings and Loan Associations
  - Exchange and exposure visits
  - Extension services in the value chain areas
  - Support for domestic and livestock water sources (boreholes)
- **Result 3: Disaster-risk reduction**
  - Support for emergency operation centres, plus equipment and capacity-building
  - Support for strengthening community-managed disaster-risk reduction and disaster committees
- **Result 4: Policy and advocacy**
  - Support for the operationalization of early action protocols
  - Support for the development of a disaster-risk management policy and implementation framework in Kilifi
  - Development of policy briefs
- **Result 5: Institutional capacity**
  - Monitoring, evaluation, accountability and learning
  - Documentation of best practices
  - Coordination and partnerships
  - Operational and administrative costs



## 4. POLICY RECOMMENDATIONS

The ICRC and its partners hope that the bilateral creditors of countries facing critical humanitarian crises, which are increasingly exacerbated by climate change, will seriously consider providing assistance through this streamlined Mechanism. **In order to support the effective roll-out of the Mechanism, interested creditors, prospective debtor countries and humanitarian actors should consider the recommendations set out below.**

### 4.1 CREDITORS: ADOPT A PRE-EMPTIVE APPROACH

**Creditors participating in the Mechanism can plan their support for future, pre-identified humanitarian emergencies.** National Societies have expressed that pre-identified humanitarian funding would increase the efficiency and impact of humanitarian assistance.<sup>31</sup> **However, this efficiency gain can only be achieved if creditors are also willing to adopt a pre-emptive approach.** That means recognizing that while emergencies can strike at any moment, response actions should be pre-planned and the required funding should be mobilized in advance. In this respect, in order to speed up the negotiation process, interested creditors may consider **strengthening coordination** between their ministry of finance (or the national authority dealing with external official lending) and the ministry of foreign affairs and/or the ministry of international development and cooperation (where applicable). Public authorities could **pre-identify the countries they wish to support.** Criteria for this identification process could include the types of instruments currently outstanding (ODA or non-ODA, long-term, previously restructured), the types of cooperation programmes in place with the beneficiary country, and the country's degree of vulnerability to climate change and/or conflict. Furthermore, in line with G20 commitments, official creditors are encouraged to continue strengthening the transparency of their bilateral lending so as to facilitate public accountability and risk assessment.

Creditors could also **build on this stronger coordination between ministries to select a set of emergencies to support in the identified debtor country.** Since official creditors each have their own development agenda and focus on specific sets of issues, they are encouraged to transparently communicate these priorities and collaborate with humanitarian partners in order to identify precise events that could trigger the mobilization of local-currency funding via the Mechanism.

Creditors for whom climate is a priority are **encouraged to consider small- to medium-scale natural hazards** in the set of emergencies that could be supported. These hazards tend to receive no international media coverage and therefore suffer from lack of available funds, which impacts the ability of humanitarian actors to implement emergency response and recovery programmes. Without support, these repeated disasters can seriously erode people's coping capacities and threaten the viability of their livelihoods.

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<sup>31</sup> F. Pichon, C. Jaime and E. Coughlan de Perez, Exploring the feasibility of SEADRIF in the Red Cross Red Crescent National Societies, Red Cross Red Crescent Climate Centre, The Hague, 2020.

## 4.2 DEBTORS: STRENGTHEN PARTNERSHIPS WITH LOCAL HUMANITARIAN ACTORS AND MONITOR DEBT INSTRUMENTS

Given that humanitarian action is often timelier, more cost-effective and more efficient when it is locally driven, debtor authorities should continue developing strong ties with national and local actors. They should also **facilitate access to the relevant ministries** for National Societies and other Movement partners. Having the National Society contribute to and/or co-create national strategies would strengthen its auxiliary role in support of the public authorities and increase the humanitarian impact for affected populations.

**Accurate monitoring of debt instruments is also recommended in order to expedite the process of identifying the right set of suitable instruments.** A given debt instrument could be more or less suited for the Mechanism depending on the repayment structure, the covenants and the ultimate beneficiary (a bilateral loan for budget support, or a loan for a state-owned enterprise).

## 4.3 HUMANITARIAN ACTORS: SUPPORT LOCAL CAPACITY-STRENGTHENING AND INTEGRATE CLIMATE CONSIDERATIONS INTO PROGRAMME DESIGN

The creation of a **technical assistance pool** would strengthen cooperation between international, local and national actors. In turn, this would promote wide adoption of the Mechanism, which would contribute to increased localization of humanitarian aid.

Within the Movement, the technical assistance pool, which could include many Movement components active in National Society development, should draw first and foremost on existing capacity-development initiatives. National Societies should be consulted on their capacity demands, which will vary from one to the next. Over time, this pool would become less and less relevant as National Societies acquire experience and expertise in such transactions.

Moreover, as climate adaptation becomes increasingly crucial for vulnerable communities, the Mechanism should contribute to the growing integration of climate considerations into the design of humanitarian programmes. The predictable and flexible nature of the RDDCM and its Standby procedure could **allow climate and disaster-risk considerations to be integrated** into humanitarian work across the disaster-risk spectrum. This approach could build on the ongoing support that the Red Cross Red Crescent Climate Centre provides to National Societies, primarily by offering guidance and tools for integrating climate science and forecasts into humanitarian work, strengthening linkages with national adaptation planning processes, and providing practical guidance on addressing climate risk across a range of sectors. While planning the programmes to be funded by the Mechanism, the National Society could call on the Climate Centre to help it integrate activities to address climate vulnerabilities before, during and after a humanitarian emergency, particularly in places where people's capacities to adapt to climate stresses are already compromised by conflict and violence.










The ICRC helps people around the world affected by armed conflict and other violence, doing everything it can to protect their lives and dignity and to relieve their suffering, often with its Red Cross and Red Crescent partners. The organization also seeks to prevent hardship by promoting and strengthening humanitarian law and championing universal humanitarian principles.

People know they can count on the ICRC to carry out a range of life-saving activities in conflict zones and to work closely with the communities there to understand and meet their needs. The organization's experience and expertise enables it to respond quickly and effectively, without taking sides.

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