I. Project Context

Country Context

The key natural hazards posing risk to the population and property in Montenegro are floods, earthquakes, landslides and forest fires. The valleys of larger watercourses, in which the largest settlements and the best farmland, infrastructure, and industry are located, are highly prone to floods. The floods occur mostly along the river courses of the Tara (Drina) and the Lim and the lowlands bordering Lake Skadar. In 2010 alone there were two periods of severe flooding, the worst in over a century, which displaced approximately 2,000 people. Montenegro is also vulnerable to low and medium-intensity earthquakes (Montenegro’s seismological observatory registered more than 200 earthquakes in 2009), and occasional major earthquakes with devastating geological impacts such as mud and rock slides. Human activity has accelerated soil erosion, increasing the landslide risk. Climate change is a major concern and is likely to exacerbate flooding, droughts and forest fires.
II. Sectoral and Institutional Context
Governments in the region have very limited financial capacity to assist their populations in regaining assets and productive capacity destroyed by natural disasters. An illustrative example of this is the 1994 Macedonia floods, which caused damage worth 77 times the amount allocated in the budget by the government for emergency response. For this reason, a basic tenet of disaster risk mitigation is the transfer of financial risk from the public to the private sector.

Catastrophe risk insurance is one of the pillars of the Bank Group’s Disaster Risk Mitigation Strategy. Catastrophe risk insurance is a means of transferring the financial and fiscal risk of disasters from government to the private sector. This not only protects the national economy as well as homeowners and SMEs, but enables more effective targeting of government assistance following a disaster, all of which become increasingly important with the global financial crisis.

The World Bank has experience in facilitating the establishment of national and regional insurance pools, both disaster-related (such as the Caribbean Catastrophe Risk Insurance Facility, the Turkish Catastrophe Insurance Program, and the Romanian Catastrophe Insurance Pool) or non-disaster related (the African Trade Insurance Facility). This is a highly specialized field and the World Bank is uniquely placed to mobilize both the expertise and the participation needed to ensure a solid foundation for such a facility. The World Bank, jointly with the UNISDR and the Swiss Secretariat for Economic Affairs (SECO), is addressing the problem of low catastrophe and weather risk insurance penetration in Southeastern Europe through the creation of the regional Catastrophe Risk Insurance Facility (SEEC CRIF), which has been recently incorporated as “Europa Reinsurance Facility Ltd# (Europa Re).

III. Project Development Objectives
The Project Development Objective (PDO) is to help increase access of homeowners, farmers, the enterprise sector and government agencies to financial protection from losses caused by climate change and geological hazards.

IV. Project Description
Component Name
Component 1: Countries’ Participation in Europa Re (The current project (APL2) proposes US$2.5 million of IBRD loan to finance Montenegro’s membership contribution to the Facility
Component 2: Technical Assistance implemented separately from and in parallel to this APL3. This program component, already financed by donor funds (SECO and GEF grants) and implemented by Europa Re

V. Financing (in USD Million)

<table>
<thead>
<tr>
<th>For Loans/Credits/Others</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
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<tr>
<td>International Bank for Reconstruction and Development</td>
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</tr>
<tr>
<td>Total</td>
<td>2.50</td>
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</table>

VI. Implementation
Institutional and Implementation Arrangements

Program Ownership and Exit Strategy. Initially, member countries will own and govern the Facility,
which gives them incentives to create and support demand for catastrophe insurance among homeowners, farmers, and enterprises. However, three years later, governments will be expected to sell up to 30 percent of their shares of Europa Re operations to private investors and, within five years, up to 100 percent to ensure a smooth transition of the Facility to the private sector.

Program Implementation Agency. Europa Re will act as the program implementation agency and the main Bank counterpart during program implementation. Therefore, Europa Re will rely on its own personnel and management company professional staff and cover all costs of management services and program implementation, funded from its own capital or donor funds. The company will produce quarterly technical progress reports on: (i) the level of insurance coverage achieved in each member country; (ii) advancements in multiple technical areas of preparatory work essential to launch catastrophe insurance products in member countries; (iii) the status of financial management and implementation of donor trust funds.

Management Company and Finance and Accounting Vendor. Europa Re is managed by a competitively-selected, privately owned reinsurance services firm that provides project management, underwriting, pricing and risk management services. The management company will also place reinsurance on behalf of Europa Re and, if necessary, will enter into alternative risk financing arrangements with risk capital providers. A finance and accounting vendor (FAV) will be selected and appointed to implement the program FM function only after Europa Re is capitalized and licensed.

Regulation. Europa Re is domiciled and regulated in Switzerland, which has a sound and advanced insurance regulatory regime. Besides the minimum capital requirements set forth by Solvency I, as of 2011, the company must comply with risk-based solvency requirements under the Swiss Solvency Test, which requires reinsurance to cover a one-in-250-year event.

Governance Structure. To ensure that Europa Re management is immune from potential political pressures that may adversely affect its operational and financial performance, company business operations are clearly separated from government ownership of the Facility. To this effect, Europa Re has retained an independent professional board of directors comprising reputable insurance/reinsurance professionals with established industry track records. Overall strategic oversight and policy advice remains with member countries’ Ministries of Finance and is exercised through the Annual Meetings of shareholders and the Advisory Policy Board.

Role of Governments. Member states’ strategic role in ensuring Europa Re success will be to provide Facility financing and to participate in Facility governance through shareholder meetings and the Policy Advisory Board. Also, member states will be expected to extend all necessary logistical and technical support to consultants carrying out country risk assessments to ensure expeditious and effective completion of these studies. Anticipated government policy support for the program may vary by country, but will likely include the following actions:

- Create the enabling regulatory and legal framework for Europa Re operations;
- Implement extensive public information and awareness campaigns about catastrophe insurance products availability and benefits;
- Implement policies to encourage homeowners and companies to adopt sound disaster risk management practices by linking mortgages in disaster prone areas to catastrophe insurance, and rationing post-disaster aid in specified amounts equal to a fraction of the insured limit; and
• Insure, through Europa Re (or similarly reliable insurer/reinsurer), government physical assets (public housing, hospitals, schools, etc.) against natural disasters.

Anticipated introduction of policy and regulatory standards in participating countries may include but not be limited to: (i) compulsory insurance for all mortgage holders residing in disaster-prone areas; (ii) proof of catastrophe insurance coverage on all properties in disaster-prone areas upon registration of real estate sales; and (iii) mandatory insurance of government-owned building stock.

Role of Private Sector in Participating Countries. Locally licensed private insurance companies in participating countries will issue catastrophe insurance policies to homeowners, farmers, and the enterprise sector, and will settle claims. The Facility will automatically settle claims from weather-related events covered under parametric weather risk contracts. To transfer catastrophe insurance risk assumed in the process of selling these products, primary insurers may enter into an optional reinsurance contract with Europa Re, which will cover a major part of the risk, if not all, under these insurance policies. Reinsurance coverage will be provided automatically for all insurance policies issued by insurers according to recommended Facility risk underwriting and pricing guidelines and administered through a web-based underwriting platform. Local insurers will be compensated through insurance commissions for distribution and claims settlement services. In addition, those insurers who choose to retain a part of risk under catastrophe risk policies written through Europa Re web-based production system 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>
<th>Yes</th>
<th>No</th>
</tr>
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<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
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<td>Projects on International Waterways OP/BP 7.50</td>
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<tr>
<td>Projects in Disputed Areas OP/BP 7.60</td>
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</tr>
</tbody>
</table>

VIII. Contact point

**World Bank**

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Email: xwang@worldbank.org

**Borrower/Client/Recipient**

Name: Ministry of Finance  
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