Increasing the Uptake of Weather Based Index Insurance in southern Africa

The advent of Weather Based Index Insurance (WBII) provides significant opportunities to enable large numbers of farmers in the southern African region to manage climate-related risks. However, its uptake remains limited largely due to issues of affordability and availability. Geographic concentration of risk and a limited market are at the core of these problems. A regional approach to risk pooling in southern Africa is expected to reduce the price of the product and to facilitate the participation of the private sector in this market, thereby enhancing access of the product by large numbers of farmers. This approach necessarily requires a cross-border policy and regulatory framework to be crafted at the regional level.

Towards a common regional policy/regulatory framework for southern Africa

In crafting a regional framework, the following elements will need to be considered:

- Adoption of a common definition of index/parametric insurance across all countries
- Identification of distribution channels in each country
- Access to data and data management for all countries
- Establishment of local risk pools as a first layer to ensure principle of proportionality
- Establishment of Public-private partnerships for product development
- Defining the administrative role of governments
- Increasing the level of awareness and insurance literacy amongst farmers
- Establishment of a dispute resolution mechanism
- Development of climate proofing mechanisms
- Establishment of a regional index insurance fund
- Independent evaluation of losses
The case for WBII

Climate change continues to be one of the biggest disruptors to agricultural transformation, particularly in the smallholder sector. Not only have weather related events such as droughts become more unpredictable, but they are occurring with increasing frequency, intensity and severity. Farmers are at the front line of the socio-economic and environmental devastation that this phenomenon is causing. Thus, weather related insurance has emerged as one of the solutions to this problem. WBII has particularly been heralded as a product which offers better prospects particularly for the smallholder sector.

Traditional agricultural insurance is generally associated with the high cost of underwriting and of claims assessment. This is due to large numbers of small and fragmented farms which are spread over large areas. Other challenges associated with in-country traditional insurance solutions include high risk of adverse selection, inability to create a large pool of uncorrelated risks and unavailability of reinsurance due to highly concentrated, and hence, covariate risks.

Weather Based Index Insurance is increasingly being seen as an alternative to traditional agricultural insurance as it offers the attraction of simplicity, quick pay-outs based on objective parametric indicators, and removal of moral hazards and adverse selection.

“Among its advantages are its simplicity, quick pay-outs based on objective parametric indicators, and removal of moral hazards and adverse selection.”

Cross-border pooling of risk

Risk pools at country level are often concentrated and therefore expensive to underwrite. This then calls for risk pooling across the different countries in order to diversify exposure and thus reduce the cost of re-insurance. This could be within a given region such as the Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC). Apart from diversifying risk in terms of differences in timing of events between participants, aggregating the risk will also diversify risk between risk classes.

International experience on risk pooling across countries is still limited. However, critical lessons are emerging from these. The Caribbean Catastrophe Risk Insurance Facility (CCRIF) is one such example. It was created by 16 Caribbean countries and its objectives are to:

• Lower insurance premiums;
• Reduce vulnerability to natural disasters, and
• Implement a comprehensive strategy for disaster management.

This facility successfully reduced insurance premiums by 41% to 53% when compared to offerings by commercial insurance providers.

Barriers to adoption of WBII

While WBII offers significant potential to enable farmers to manage climate-related risks, the product is not widely available in the market. The limited availability is associated with the relatively small size of the market which makes it difficult for the product to be provided on a commercially sustainable basis. In addition, the product is currently expensive and thus unaffordable to the generality of farmers. The high price is largely attributable to the high re-insurance costs which are mainly due to the geographic concentration of risk.

These barriers can be overcome by adopting a regional approach which SACAU has been exploring.
Towards a regional framework

The conclusion of work undertaken by SACAU on improving access to WBII by farmers has lent support to a cross-border approach. This was corroborated by a cross section of stakeholders from both the private and public sectors.

A cross-border approach necessarily requires enabling policy/regulatory frameworks configured at a multi-country level. The development of such frameworks will need to consider a number of key elements which are already highlighted on the first page of this brief (towards a common regional policy/regulatory framework for southern Africa). The framework should be underpinned by high level goals and specific objectives.

The four goals are:
- Promotion of a regional approach;
- Enhancing access and availability of the product;
- Investment in weather-related infrastructure and systems, and
- Establishment of a regional fund.

The specific objectives are, to:
- Ensure a clear understanding of the impact of climate-related risks;
- Set out a clear and concise plan for risk management;
- Prevent the transfer of potentially catastrophic costs to farmer communities and help them to recover quicker, and
- Forge links across various countries for the aggregation of climate risks in the region.

“WBII is generally not available in the market and is expensive and unaffordable to the generality of farmers.”

Conclusion

With improved access to WBII, farmers, particularly smallholders, will be better equipped to build resilience against climate change which has become one of the biggest risks that they have to contend with in the face of increasing complexity of agricultural systems.

SACAU notes that some existing protocols in SADC already can accommodate some elements being proposed. Thus, instead of promoting or advocating for a stand-alone policy/regulatory framework, it will be more effective to latch onto existing frameworks to expedite the process. In this regard therefore, the possibilities of integrating the different aspects/elements identified by SACAU into ongoing and future risk management processes, frameworks and strategies to facilitate risk pooling across countries in the region will be explored.

In addition, SACAU considers it important to catalyse the development of a “community of practice” on WBII in the region. This will start by convening a stakeholders’ forum that will meet at least once a year to carry this work forward and to generate more interest in and support for the product and its wider adoption by farmers.

Success in this work will ensure that agricultural transformation in the sector is not compromised, and that vulnerable primary producers are not further exposed to ever-increasing risks associated with climate change.
Further reading

About SACAU
The Southern African Confederation of Agricultural Unions (SACAU) is a membership based regional farmers’ organisation representing the common interests of farmers in southern Africa. Its core membership is drawn from general interest apex national farmers’ unions in southern African countries and it currently has 18 members from 12 countries.

SACAU
Unit 9, Block 2, Falcon Crest, 142 South Street, Lyttelton, Centurion, Pretoria
P O Box 10480, Centurion, 0046, Pretoria, South Africa
Tel: +27 12 644 0808 | E-mail: info@sacau.org | Website: www.sacau.org

The views expressed in this information product are those of the Secretariat and do not necessarily reflect the views of SACAU. This document has been produced with the financial assistance of Technical Centre for Agricultural and Rural Cooperation (CTA). The views expressed herein are those of the SACAU Secretariat and can therefore in no way be taken to reflect the official opinion of CTA.