Access to Insurance Initiative

A global programme for sound regulatory and supervisory frameworks

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"Agricultural Insurance"

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Agenda

1. **Agricultural Insurance**
2. Index Insurance

Supervisory Challenges

- Agricultural insurance is unlike most microinsurance
- Nature of the product can create regulatory issues
- Complexity and risk characteristics can create supervisory challenges
- Other stakeholders can play important roles

Product Design Parameters

- **Property covered**
  - Crops, livestock
- **Key risks**
  - Physical, biological
- **Type of coverage**
  - Indemnity, index, combination
- **Scope of coverage**
  - Micro, meso, macro

Consumer Demand Issues

- Market should be large
- Products can be difficult to understand
- Insurance must be financially attractive

Challenges for the Insurers

- Technically challenging
- Catastrophe and geographic concentration risk
- Need to build scale

1. Agricultural Insurance
2. **Index Insurance**

- **Small scale farmers – that is most farmers – were excluded from crop insurance before index insurance**
- **Index insurance overcame the obstacle of costly claims assessment and moral hazard using parameters that correlate with crop losses**
- **Greatest innovation in insurance for a long time, created a completely new approach to risk transfer**
- **But index insurance differs in a number of ways from traditional insurance, and this has implications for regulation and supervision**

- Claims payments do not relate directly to loss – only statistically
- A lot of statistics expertise is required to design and price index insurance – and thoroughly understand it
- It‘s not straightforward to tell a “good“ index insurance from a “bad“ index insurance product
- It‘s all about “Basis Risk“
- The prime objective of much index insurance is to make agricultural insurance work for small scale farmers — index insurance is often microinsurance

Why regulate Index Insurance

- So far, most pilots have been launched with regulatory dispensation – but that does not crowd in the insurance industry
- So far, most target clients have no experience with any insurance – so they need special protection (remember Basis Risk)
- So far, most insurance companies have no experience insuring small scale farmers, low income households, or index products – so they need to be encouraged

- **But (agricultural) index insurance can be micro, meso or macro**
- **Where does the index come from? The role of national met agencies, agriculture statistics agencies, and government / agencies in general**

The Bigger Picture

- Agriculture insurance is about more than insurance: agriculture is a complex universe of value chains, market forces, habits, socioeconomic structures, institutions and their governance, access to finance, climate change, food security, government policies and objectives, interest groups etc.
- Other stakeholders have important roles
- Unlike life insurance or car insurance, the benefits of agriculture insurance in any country will depend on many aspects beyond the reach of the insurance industry and supervisors
- You cannot control them - but you need to understand them

Index Insurance – Legal and Regulatory Issues

- Index insurance – legal and regulatory risks
- Few countries have legislation or regulations
- No IAIS standards or guidance
- IFRS ambiguous
- So, can an index risk transfer product be considered insurance at all?
- Does it matter? Why not a derivative?

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Index Insurance – Legal Issues

- **Many types of index insurance, but two categories:**
  - Aggregate loss (e.g. area yield & area livestock mortality)
  - Indirect loss (e.g. rainfall, temperature, wind speed)
- **No requirement to prove amount of loss or even sustain a loss**
- **Payment depends on premium paid and value of index**
- **Index products can be designed to pay in advance of insured event**
- **Index insurance is not indemnity insurance**

Index Insurance — Special Type of Insurance?

- **Can index products be considered as fixed sum or contingency insurance**
- **Not traditional approach —most contingency products personal lines (e.g. life)**
- **Key elements if not indemnity insurance:**
  - Insurable interest or insured event adverse to interests of insured
  - Principle purpose of contract transfer of risk

Complexity and risk characteristics can create regulatory and supervisory challenges

Customer side — Consumer protection, esp. retail products:

- Basis risk
- Fair contracts
- Insurable interest
- Appropriate provisioning

Insurer:

- Pricing
- Provisioning
- Adverse selection

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