Micro-insurance offers farming families in Malawi protection from weather related risks and death in the household

By the Malawi Oilseeds Sector Transformation (MOST) Programme

As a smallholder farming household in Machinga's Misolo Village, Patrick Yotam and his wife Agness James had been growing cotton on their farm for years with Afrisian Limited before death struck in their home on 24th October 2017 and took away Patrick for good. *"The pain of losing my husband has been unbearable, but I am very grateful that we have been able to use the K75,000 from insurance to reimburse us for funeral expenses"* said Agness, when she received the NICO Life Insurance pay out through Afrisian Limited's Regional Manager, Ganizani Stephano.

In Blantyre Rural's Kamoto Village, Mr Rabson Nangalaka also a cotton smallholder, is all smiles after receiving a payout through Afrisian, a cotton ginner, for dry spells in the 2017/18 crop growing season.

"This has never been heard of in cotton" says Rabson. *"For the very first time in my life, I have been compensated by insurance for loss of the inputs I used."* Rabson and fellow smallholders have been experiencing the ravages of drought over many years without the benefit of any insurance cover. In 2016, together with fellow smallholders he signed up for an incentive-based contract farming (IBCF) scheme with Afrisian that included Weather Index Input Insurance (WIII) for cotton covering both drought and excessive rainfall. This product, offered by United General Insurance Company Limited (UGI), was changed to Drought Input Insurance (DII) in the 2017/18 growing season, after research showed that there was need to focus on the greater risk of drought (rather than excess rainfall) that smallholders face.

The need for micro-insurance interventions

Across the globe, low-income smallholder farming communities are very often excluded from accessing formal financial services, like insurance and credit, because they cannot afford the required premiums, are reluctant to part with what little financial resources they have, are largely illiterate and do not understand financial services, lack collateral and do not have any formal credit history.

The MOST programme has been working in various oilseeds markets, and recognized the importance of access to farm inputs particularly for growing crops like cotton. With the breakdown of the cotton input supply, due to years of side selling and unrealistic crop price setting, the MOST programme devised a new approach to contract farming that would enable smallholders to get the necessary access to seed and agro-chemicals ('inputs') for growing cotton, while ensuring compliance to the contract through providing incentives for supplying crop and repaying input credit. This was termed incentive-based contract farming (IBCF) as the approach was to provide a package of increasing incentives starting with a basic pack, such that smallholders who satisfied their contracts, would get greater access to input in each subsequent year. If smallholders could see a positive benefit from complying, then barring the effect of risks beyond their control, then they would have both the means, in the form of inputs, and the motivation, in terms of incentives, to fulfil their contracts.

Recognising that there are risks that can prevent smallholders fulfilling their contracts, MOST identified two important risk that micro-insurance could address, being drought and death within the household. The cost of providing individual policies to smallholder households is too expensive for insurers to consider, due to both the cost of finding and signing up smallholders, and the administration of such policies, as they would have to be written individually and the mechanism for paying out would be expensive. The solution was to offer these insurances via aggregator businesses, such as Afrisian who wish to buy crops like cotton and are motivated to provide these insurances, both to mitigate risk, and, importantly, as an incentive to increase the loyalty of farmers who decide to work with them. The whole intention is to operate in a way that is commercially viable for all parties involved.

UGI and NICO Life, with the support from the MOST programme, developed a Drought Input Insurance (DII) product and a Funeral Expenses Insurance (FEI) product, respectively. These have been used by Afrisian, as part of its incentives for smallholders to fulfil their contracts under their IBCF scheme and to remove two key risks to contract delivery.

Drought Insurance in cotton

According to Zachariah Anil, General Manager of Afrisian Limited at a press conference organised by UGI: *'We recognise that farmers in our contract farming scheme worry about repaying the cost of inputs, if they lose the crop through drought. We were therefore very excited by the DII product from UGI and MOST, as it ensures that farmers' inputs are covered by insurance with the aim that through the insurance pay outs, the farmers can replant or clear their input debts."*

The DII cover is designed to compensate farmers for losses incurred due to a dry spell during the first six weeks following cotton planting. Should the DII cover be triggered by the stipulated period of six dry days, farmers receive pay-outs up to the equivalent value of inputs utilised on one acre of land. The inputs include cotton seed, herbicides, foliar fertiliser and crop protection products.

MacDonald Chibwe, UGI's Chief Operating Officer affirmed that they have always looked to innovate and offer products that protect people from significant risks, and was really excited about offering a drought product to the rural market, which has generally been ignored by other insurers.

Following long dry spells experienced in most cotton growing areas in the country in January and February 2018, UGI paid out under its DII policy with Afrisian. Out of the insured group in the IBCF scheme, 516 smallholders qualified for MK 2.74 million for input losses incurred. As the inputs were received on credit, the insurance pay-outs were used to clear their input debts with Afrisian, and in some cases to pay balances to smallholders for loss of their inputs.

Joseph Saiti, Access to Finance Consultant/Manager at MOST, commented that: *"There is always the risk that smallholders and their households may be ensnared in poverty through crop losses due to weather shocks, with drought being such a regular factor these days. At MOST we have been interested in stimulating the insurance market by proving it is possible to offer these types of inclusive insurance products to smallholder farmers leading to further innovation for the benefit of the farmer"*

How the drought input insurance cover works?

The DII product was introduced to mitigate risks associated with erratic weather events, such as dry spells. This type of insurance is based on a specific index – for example rainfall. The extent of rainfall, as measured by satellite for a particular area, determines the level of insurance pay-outs. A key factor is that satellite data is collected and made available at no cost, by the UK's University of Reading, an independent party covering the whole of Malawi. This means there is no room for data manipulation or human error. The insurance cover pay-out is triggered based on rainfall measurements common to a particular area, being Afrisian's cotton buying locations and not each smallholder's cotton field. The use of satellite estimation of rainfall for an area makes it cheaper to implement the insurance cover, s there is no need for physical verification of the actual loss suffered by the smallholders. While this can mean individual smallholders may either receive more than they are technically due, and others less, the vast majority will get a reasonably accurate payout.

Funeral Expenses Insurance

Death is an ever-present risk, and results in immediate hardships for the bereaved family, as they struggle to get resources that would help with immediate funeral expenses. The bereaved family has to buy a coffin, food for mourners and other funeral expenses, while coping with the loss of a key household member. The impact of the loss is lessened if the smallholder or his/her immediate family members have funeral expenses insurance (FEI) cover.

For smallholders to access the FEI cover from NICO Life, they need to be working with an aggregator, such as Afrisian. The aggregator works directly with the farmers, registering them for the contract farming schemes. The premium is paid by the aggregator and any pay-outs in times of death are paid to the bereaved family through the aggregator. The claims process is kept simple:

Cosmas Luwanika, NICO Life's Assistant Bancassurance Manager says: *"At NICO Life, we require very simple proof of death to enable the insured smallholder farmers and their families to make a claim. They may give us a death certificate, a hospital report or even a stamped letter from the village headman supported by the leader of the deceased's place of worship. The evidence is then routed through the aggregator or contracting company who will send it to NICO Life. We always promise to pay within 72 hours"*

In terms of the actual payout: *"To quicken the delivery of the payout to the bereaved family, we have an arrangement with Afrisian, where they will pay to the family immediately they receive proof of death from their field staff and claim the money from us"*, reports Cosmas. *"This way, the bereaved families get to receive the money even before they have buried their dead."*

At one of the smallholder meetings organised by Afrisian, Cosmas, had this to say to the farmers: *"As a leading player in the insurance market, NICO Life will always strive to meet the needs of the marginalized groups by providing very low-cost insurance. We were able to do that in the past through funeral cover that we offered through mobile phone operators in Malawi. However, through our collaboration with the MOST Programme, we have come to see how much lower we can price these products to make them accessible to the wider low-income market in Malawi. Depending on the numbers of people insured per scheme and the expected mortality rates, we have been able to go as low as K400 per year per smallholder farmer for a benefit of K75,000".*

Cosmas concludes: *"In Malawi, we respect our dead and sometimes end up spending far beyond our means during funerals. We want the people to rely on us in such trying times. That is the reason for our existence. We are glad that through collaboration with Afrisian and the MOST Programme's technical support, we continue to realize this vision"*

Some lessons

From the review of the insurance interventions, the MOST team has learnt that, in the first pilot, weather input insurance (WII), which covered both drought and excessive rainfall, was not, as well received as FEI by farmers and aggregators for the following reasons:

- WII is more complex with more technical detail than FEI, in that a pay-out is dependent on set trigger points whereas a pay-out for FEI is made on the occurrence of death;
- WII included both drought (50%) and excessive rainfall (50%) cover which meant that payouts were split between the two elements and therefore, smallholders who experienced drought were paid just a portion of the total sum assured.
- The pay-out for FEI is automatic and dependent only on submission of simple proof of death from the deceased family; and
- The family of the deceased farmer is very clear on the agreed pay-out for FEI, whilst WII is dependent on rainfall data which the famers cannot access though they know the general state of rainfall.

Challenges of implementing Inclusive Insurance

DII is a relatively complex insurance cover for most smallholders. Although, the need for drought insurance is obvious in areas that are drought-prone, low income communities require a lot of convincing of the benefits of having this cover. This is where provision of the cover as an incentive paid for by the aggregating or contract scheme operator makes sense. In the case of cotton, Afrisian paid the premium so that smallholders were not left in debt for lost inputs, creating difficulties for Afrisian to supply inputs in future.

Additionally, if the insured event does not occur to the extent of triggering a payout, farmers may not see any benefit in getting insurance cover. The proof of the pudding is in the eating, and there is probably no greater proof of the importance and benefits of insurance than personally (or someone else known by the farmer) seeing a payout from the insurance company when the insured event occurs.

The whole concept of insurance is foreign and unfamiliar to most low-income earners in Malawi. The Reserve Bank of Malawi says that insurance coverage in Malawi is low with a penetration rate of below three (3) percent of the adult population. This lack of knowledge and understanding has required a lot of training for the smallholders about how insurance works. By leading first with FEI, smallholders contracted by Afrisian could see that there were payouts. With FEI, there is a binary outcome. There are no debates about whether a payout is due or not. All that is required is the evidence that the insured person is dead. This is easy for smallholders to understand, and seeing that some families received their payouts gave them confidence that there would be merit in the more complicated drought product and that being part of Afrisian's IBCF was a good thing. Afrisian, partly as a result of the insurances, alongside the access to inputs, have found a very appealing package for smallholders that means they want to be in the scheme and have a stronger motivation to supply their cotton and pay off any credit. Afrisian has moved from a market player with less than 15% market share of raw cotton bought, to between 45-50% of the market. Other cotton ginners are seeking to copy.

Regulation and Inclusive Insurance

While a number of developing economies in Africa and elsewhere are said to be enjoying the benefits of implementing inclusive or micro-insurance for many of their low income people, inclusive insurance is an infant market in Malawi and therefore its regulation is not provided for in the current financial services law of the country. At the *Innovations in Rural Insurance* workshop for the insurance industry organised by the MOST Programme held on 27th July 2017, Martin Magomero of the Reserve Bank of Malawi (RBM) advised the insurance industry players that the RBM Governor, as the registrar of financial institutions, in conjunction with market players, will develop and implement a regulatory and supervisory framework for inclusive insurance. He affirmed that the development of inclusive insurance offers an important opportunity for low-income households to access affordable insurance products. He noted that it has been proven that some form of incentives can be a significant factor to increase the uptake of new insurance products. He advised that potential incentives for consideration include: exemption of value added tax on premiums for inclusive insurance business, exemption of stamp duty on inclusive insurance policies, lower corporate tax rate on profits from inclusive insurance business; and lower minimum capital requirements for inclusive insurance providers. These could be very helpful.

Opportunities for Inclusive Insurance Products

The MOST team believes that both DII and FEI could be used in many ways. Firstly, it could be offered as a means of increasing smallholder loyalty to crop aggregators and contract farming operators that provide insurance as an incentive. Secondly, the insurance products could also act as alternate means of funding smallholder resilience and/or disaster relief initiatives by Government, NGOs or development partners. Thirdly, these micro-insurances could be instruments for stimulating smallholder agriculture whereby input suppliers and financial service providers use insurance for mitigating risks, such as drought and excessive rainfall. Judging from the response from low-income smallholders who have had the opportunity to use these products, these types of micro-insurance products could be one way of improving access to formal financial services for previously excluded or marginalised low-income groups.

Cuan Opperman, the MOST Programme's Team Leader affirms the importance of the insurance interventions as follows: *"Taking the long view, it is our hope that through the low cost and simple to understand insurance products for the mass market such as FEI, many low-income people will get to learn how insurance works through first-hand experience. This in turn may motivate more aggregators or smallholders themselves to use risk mitigating products building smallholder resilience."*