

Market development in Ethiopia: changing regulatory structure and capacity building

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Introduction

- Many index insurance pilots in Ethiopia in the last three years.
- Observations on how these have been structured and challenges for going to scale.
 - Capacity constraints are present, but also regulatory and policy uncertainty that would likely affect insurance when sold at scale.
- Discuss changes in regulation, initiatives to develop regulatory framework, and investments in capacity.

Overview of Ethiopian Insurance Industry

(Smith and Chamberlain 2010)

- Private insurance companies were nationalized by the socialist regime that prevailed from 1974 to 1993, and taken over by the government-owned Ethiopian Insurance Corporation.
- Privatization in the mid 1990s brought in a number of other insurance companies, now about 12.
- EIC still has half of the market.
- Small industry: less than 300,000 clients, in 2006/7 premiums totalled US\$105m.
 - Life insurance is about 6%, the rest is general insurance.
 - Predominantly car insurance: 43% of premiums are derived from motor vehicle insurance.
- Nearly all urban.
- Some multiperil agricultural insurance offered by Nyala, Oromia, EIC and perhaps others. Tends to be for larger farmers (5 hectares) that are producing seed for distribution.

Overview of Ethiopian Insurance Industry

In addition to being concentrated and urban. Insurance industry is characterized as follows (Smith and Chamberlain 2010):

- “Many small insurers displaying high levels of inefficiency” – mainly still paper-based systems.
- “Low and potentially overstated solvency levels due to, amongst other reasons, limited risk assessment and management capacity, limited and illiquid investment options and the pervasive practice of selling insurance on credit (with uncollected premiums eventually resulting in bad debt).”
- “heavy dependence on the banking sector for both referral credit insurance business and returns on investment from shares held in banks”
- “limited availability of technical skills for product development and management (e.g. actuaries)” –restricts the development of new products.

Many weather-index insurance pilots...

Insurer	Intermediary	Partners	Year	Region	Number insured
EIC	None	World Bank	2006	SNNPR	28
Nyala	Coop	WFP	2009	Oromia	137
Nyala	MFI	IRI & Oxfam	2009	Tigray	200
Nyala	MFI	IRI & Oxfam	2010	Tigray	1,300
Nyala	Coop & iddir	IFPRI & Oxford	2010	SNNPR	498
Nyala	MFI	IRI & Oxfam	2011	Tigray	
Nyala	Coop	IFPRI	2011	SNNPR and Oromia	
Nyala	Coop	FAO & UCSD	2011	Amhara	
BG MFI & Oromia	iddir & indiv	IFPRI & Oxford	2011	Oromia	

Features of index pilots to date

- Weather indices (satellite or weather station indices).
- Indices and payout scales designed by western researchers or consultants.
- When reinsurance has been bought it has been purchased from SwissRe by Nyala.
- All new products regulated by the Insurance desk at the National Bank of Ethiopia.
- Used two means of retailing to smallholder farmers:
 - Selling to cooperative members
 - Selling through a microfinance institution

Use of intermediaries for retailing

- Neither coops or MFI are legal insurance brokers or agents
- The system has been the following:
 - Interested farmers sign up for insurance with the coop or the MFI.
 - The coop or MFI signs a contract with the insurance company on behalf of all those listed.
 - Insurance certificates are distributed to all those farmers listed on the master policy.
 - Premium payments and payouts are made through the coop or MFI.
- Cheaper for insurance companies to transact with these legal entities rather than farmers.
- Coops have also paid the premium allowing farmers to pay for insurance only if there is a good harvest.
- 2010 iddir pilot –successful at encouraging demand from farmers, but groups are small and rural, so still high transaction costs for insurance firms.

Cooperatives

- During the Derg rural households were coerced to be members of cooperatives, they were disbanded.
- Now cooperative promotion in Ethiopia is governed by Proclamation No. 147/98, which defines a cooperative as “a society established by individuals on voluntary basis to collectively solve their economic and social problems and democratically manage same”.
- Three levels of cooperative formation in Ethiopia:
 - Primary (groups of 20 or more farmers),
 - Union (group of primary cooperatives), and
 - Federations (group of unions formed at the regional level).

Cooperatives

- Insurance contracts are with unions.
- Many services provided through the coop—traditionally gv input provision and input credit is through coop, extension, marketing.
- Government policy envisages that cooperatives could serve as a link between financial institutions and rural households.

MFIs

- Sector that started recently and has grown rapidly since then: 28 MFIs operating in the country (National Bank of Ethiopia, 2010).
 - Total assets of ETB 6.6 Billion, credit outstanding of ETB 4.9 billion, and saving mobilization of ETB 2.1 billion (National Bank of Ethiopia, 2010).
 - 1.73m active clients (Amha, 2008).
- Dominated by large regional MFIs—ACSI, DECSI, OCSI, and Addis Credit and Saving Institution—account for about 90% of all assets, credit, saving and capital. These MFIs have their origins in regional government affiliated, semi-NGO credit institutions. Still receive assistance from regional governments.
- Two of these MFIs are the two largest in Africa.

MFIs

- Rural client base, focused on the active (or working) poor.
- Mainly savings and group based loans.
- Unlike other countries a considerable proportion of loans are made for crop production.
- Are implementing electronic management information systems and have experience on large scale operations in rural areas.

Why such interest for pilots?

- Need for insurance against weather related risk: Dercon, Hoddinott, and Woldehanna (2005) almost half the households were affected by drought sometime between 1999 and 2004.
- Substantial resources from government and donor community on food aid and safety nets. The purpose of these programs could be well-served by improved private insurance markets. Increasing awareness of the need for insurance in the Household Asset Building Programme that is one of four components of the Government of Ethiopias Food Security Programme.
- Relatively good network of weather stations that have been collecting data for a long time (although data is patchy).
- Insurance industry in which innovation in product design is allowed and government quite supportive of pilots.

Why so little scaling up?

Despite many (not unsuccessful) pilots, little scaling up. Why?

- Limited capacity to design products, few companies have links to reinsurers that could help.
- Constraints in retailing at scale:
 - Insurance companies have limited rural retail network,
 - Considerable leadership in innovation in pilots, but no systems for going to scale.
- Data constraints: most NMA stations are manual and NMA is under-resourced, so ensuring timely data requires follow-up.
- Regulatory uncertainty: it is not clear what the regulatory framework for index insurance is, who will be able to sell it (especially given recent regulation), and what the role of the government will be.
- Perceived market uncertainty of those who have not entered: the lack of observed scaling-up has caused scepticism amongst some in the insurance industry.

Addressing constraints

- Building capacity for designing products.
- Learning about effective mechanisms for retailing at scale—changing regulatory structure may influence this.
- Investing in the National Meteorological Agency.
- Reducing regulatory uncertainty through developing a policy and regulatory framework.
- Information sharing on pilots and lessons learned.

Changing regulatory structure

- In May 2009 the “Microfinancing business Proclamation No. 626/2009” was passed and declared that MFIs could engage in “micro-insurance business as prescribed by the directive to be issued by the National Bank”.
- There is no directive yet. A standing group has been set up to address this involving the insurance and microfinance desks at the National Bank of Ethiopia.
- Currently some insurance has been issued: credit-life, also additional life insurance and health insurance. This is regulated by submission of product design to the National Bank.
- MFIs have not been issuing insurance for weather-index insurance, this requires more consideration be given to risk-financing.
- One MFI plans to sell weather-insurance at scale this season, and piloting is allowed.

Changing regulatory structure

- Advantages:
 - Vibrant sector has attracted capable and innovative individuals.
 - Have a good rural retail infrastructure, and a large rural client base.
 - Experience in explaining and selling products in rural areas.
 - Also about how to sell to groups of individuals and structure group contracts.
 - Large asset base.
 - Seen as less political than cooperatives.

Changing regulatory structure

- Concerns:
 - New to the types of risk financing and management that is needed to sell insurance for covariate risks. Cannot really purchase reinsurance contracts (would most likely need an intermediary).
 - Microfinance regulator does not have experience in regulating insurance contracts.
 - When a bad event occurs they will likely face both reduced loan repayment and high payouts.
 - Default incentive structure is to prioritize insurance sales to their borrowers.
- Potential for risk sharing between MFIs and insurance company or developing other working relationships (partner-agent model).

Piloting new institutional arrangements

- Opportunity to influence the formation of a directive through learning from pilots.
- We are piloting risk-sharing between MFI and an insurance company this season.
 - MFI and insurance company are splitting premiums and payouts.
 - The insurance contract is issued in the name of both organizations.
 - The MFI is making sales (to individuals and iddirs) and administering payouts.
- What we have found so far:
 - Improves the credibility of the product to farmers.
 - Takes advantage of MFI infrastructure, staff and skills.
 - Allows reinsurance to be purchased – were reinsurance to be purchased it would be purchased by the insurance company.
 - Allows the amount of risk held by the insurers to be higher.
 - Requires a willingness to work together on behalf of both.

Reducing regulatory uncertainty

- Additional uncertainty around index insurance could be addressed by a clearer regulatory framework for index insurance and a policy framework indicating government involvement.
- Diagnostic study for designing a broad based microinsurance scheme in Ethiopia being undertaken as part of the Productive Safety Nets Programme (the Household Asset Building component) to make recommendations on these issues.
 - Looking at experiences in Ethiopia and internationally (India, Mexico and Turkey)
 - Considering a wide variety of indices (area-yield, NDVI and weather)
- Discussion of report by a broad based stakeholder group in the fall and drawing a national action plan.

Capacity for designing insurance

- So far, design of all contracts has been by researchers or consultants.
- Considerable investment in tools to enable others to design insurance products, but not yet used.
- Introductory training workshop was held by 14 teams in December–60 attendees from insurance companies, MFIs, government, NGOs and donors.
- Some attended the World Bank training in January.
- Further training likely needed – in particular high demand for introduction on designing contracts and operationalizing insurance sales.

Capacity for designing insurance

- Not just training, also:
 - Increased actuarial capacity.
 - Better links to reinsurers who will advise on product design:
e.g. Endurance RE or MicroEnsure's reinsurance facility with Hollard Insurance Company of South Africa.

National Meteorological Agency

- Investment in changing weather stations to automatic would help.
- Considerable human capital in modeling weather systems, but little resources for active research on this issue. More research on this would inform the design of weather based indices.

Addressing hesitance

To address hesitance of other insurers about the number of pilots:

- Start a dialogue in which progress of ongoing pilots is communicated.
- Share lessons of past pilots, after 9 pilots we should have already learned quite a bit.
- Diagnostic study will be doing some of this work.
- ILO is proposing a workshop in the fall that would also be a forum in which lessons from pilots are shared.

Conclusion

- 14 funded researchers will be well-placed to:
 - contribute to dialogue on regulatory framework—sharing lessons on institutional design could be particularly important,
 - build capacity for designing insurance products,
 - connect insurers with reinsurers that can provide advice and guidance on product design.
- Target audience for our results will likely need to be broader than insurance companies and MFIs. Will likely need to include reinsurers and a wide range of government actors.