Agricultural and climate risk insurance for smallholder value chains: Identifying common challenges and solutions

Successful and sustainable roll-out of agricultural and climate risk insurance schemes for smallholder farmers and their value chains is a complex task involving many stakeholders. Many of the challenges or roadblocks that hinder insurance workstreams are common across different countries and contexts. This brief identifies and describes the principal challenges, and outlines possible solutions that development programmes can support. It is aimed at rural and agricultural development projects in the process of identifying potential insurance activities that will strengthen poor rural people’s resilience and their capacity to adapt to climate change.

Challenges are identified at three levels: demand for insurance, supply of insurance, and the enabling environment, which includes the policy, legal and regulatory frameworks. The corresponding proposed solutions can be supported by development projects, government, donors, and the financial and agricultural sectors.

DEMAND

**Challenge 1**
Smallholder and agricultural value chain risks and risk management strategies or patterns are not clearly identified and understood. The risks and constraints faced by target groups and stakeholders, and the risk management strategies that are available or needed, are often not well analysed before deciding whether or not to embark on rolling out or improving an insurance scheme.

**Solution**
Conduct agricultural value chain risk assessments. Analysis and recommendations to choose insurance as a risk management strategy should be based on a clear understanding of the target group's situation and on a screening of the current options. Assess the risk management needs, constraints and patterns of farmers and other relevant stakeholders in value chains. Assessments should clarify whether insurance of any type is the right tool. If there is a need for insurance, consider whether formal insurance is suitable or whether informal or semi-formal risk-pooling options, or a combination of other risk management measures, may be more appropriate for the target group.¹

**Challenge 2**
Lack of awareness and understanding; the target group has limited understanding and trust of insurance. Lack of awareness and understanding of insurance as a risk management tool persists among smallholder farmers. It is often a reason behind weak uptake of insurance and also creates difficulties with the effective use of insurance policies when they have been purchased. As a result, farmers may not benefit effectively when a loss or damage occurs or they may misunderstand what they are and are not covered for. Furthermore, they may exclude themselves from benefiting by not taking appropriate risk management measures (for example, vaccinating livestock). There may also be low renewal rates after first purchase, with farmers unwilling to pay regular premiums to continue insurance coverage if there are no payouts in the first season or period of coverage.

¹/ For more information, see: PARM toolkit: Assessing and responding to agricultural value chain risks. (PARM, forthcoming 2021).
Challenge 3
Affordability issues; lack of ability and willingness to pay.

Solution
Develop education in risk management and insurance; assess the value of insurance options to clients and aggregate measures that foster trust.

Develop and implement education in risk management and insurance. Education should aim to ensure that clients understand: which risks are insurable; how insurance works; what is covered and what is not; what other complementary risk management tools are available; what they can expect when they purchase insurance; what to do when there is a claim; and how to renew the contract. At each step:

- Education measures can be part of the insurance scheme, or separate and implemented in another agricultural or financial development context.
- They should be adapted to the needs and constraints of the target group, delivered through accessible channels and formats, and take account of gender considerations.
- Education can be developed to use public channels such as extension workers. Other solutions are increasingly popular, including village-based approaches, or technology such as gaming, mobile apps or USSD menus.

Assess the value insurance brings to clients. If governments or other stakeholders want to improve existing insurance schemes, projects can support client value assessment to identify issues and propose solutions. Note that client value is not just about affordability, it is also about the benefits the insurance should mitigate a priority risk or risks, and compensate enough in a reliable, timely and transparent way. The product, services and delivery channel should be accessible and trusted, and the insurance should increase access to and use of other products and services to improve and stabilize production.

Integrate measures that foster trust in insurance and in the insurer. A key aspect early on in establishing trust in insurance is building farmers’ understanding of what is covered by the insurance and what is not. Smallholders may have greater confidence when their association is involved, or testimonials from their village are available. Experience shows that communicating payouts publicly is an effective way to build trust. Another option is bringing insurers or regulators to rural areas to speak directly to farmers and address their concerns. Finally, trust can be strengthened by setting up or expanding insurance schemes using trusted delivery channels that are in close proximity to clients, and are already providing other services to which insurance can be linked, such as credit or inputs.

Challenge 4
Inspection feasibility; assessment feasibility; policy feasibility.

Solution
Develop and test: finance feasibility assessment for specific, targeted and roll-out of an insurance product.

Financing feasibility studies. Feasibility studies for insurance schemes are a crucial first step before deciding whether or not to proceed with product design, and defining what kind of products or alternative or complementary support measures are affordable. They should be carried out by insurance practitioners or consultants.

Support design or adjustments, testing and roll-out of an insurance product. An insurance pilot with a clear exit strategy, which supports the design, testing and roll-out of an insurance product, can make sense for a period until sufficient experience is gained in-country. A good period of testing, monitoring, validating and evaluating product performance and accuracy is required, over several seasons. After roll-out, product adjustments should be made in a continuous way, based on findings.

Challenge 5
The capacity of insurers is constrained.

Solution
Deliver focused training and coaching to insurers.

Any training for insurers should consider the entire process and involve staff at different levels. Aim to get a critical mass within an institution or country to avoid the risk of frequent staff turnover. Insurers are likely to need capacity-building in the areas of scheme or business model development, product development and process coaching.

- Scheme or business model development. This is particularly important in order to overcome the challenges of operating with smallholders and other actors in the value chain. State-owned insurers may not be able to increase penetration, even with subsidies. Commercial insurers may not understand the viable business opportunities exist in working with aggregators and delivery channels close to smallholder farmers. Insurers should be supported with assessments in order to understand the needs, opportunities and experiences of the target group (if there is an existing scheme) and possible linkages with appropriate aggregators. Technical support should be made available on related business model development and scheme options.
- Product development. Many insurers choose not to develop products in-house; their main role will be in understanding the product and underwriting the risk. In this case, they need to be linked with a suitable service provider or reinsurer who then develops the product. Nevertheless, it is important for these insurers to understand how a product works in the rural and smallholder environment, and they must also be able to monitor it and understand how to implement and monitor it. On the other hand, some insurers will want to develop products in-house, in which case they will need more hands-on training. In some cases, it might be appropriate to develop the capacity of other institutions beyond insurers, including those already involved, or with potential to be involved, in product development. This may include regional insurance technical service providers, agricultural statistics/remote-sensing bodies, and/or in-country technical working groups or technical support units.
- Process coaching. Process coaching can help insurers understand how to map and assess their processes, identify where bottlenecks occur in scheme delivery and clarify how to make improvements. This can be particularly important to improve the processes that benefit clients, such as claims processing and payouts. Insurers may need process coaching over an extended period, rather than training, and may also require technical advice, training and other support to improve their systems – for example by using digital platforms to increase efficiencies.

Challenge 6
There is no suitable distribution structure or delivery channel in place.

Solution
Set up or expand schemes using trusted delivery channels.

Generally, it is not the insurer that is the “face” of the product, but the institution that enrols clients and deals with the different delivery processes, such as marketing and payouts. This is because if insurance regulations allow the use of the specific delivery channel, such as a credit union, agribusiness (offtake), MFI or farmers’ association. Ideally, delivery channels should be entities that aggregate farmers, are located in close proximity to the target group and are already providing other products and services to farmers. Outreach in relation to existing products can also be expanded to the target group by on-boarding such delivery channels. These approaches should also be motivated to help select, train, and institutionalize insurance agents in remote areas.

3/ For more information, see: Rapid prototyping for inclusive insurance in the Insurance Toolkit (FAO, 2021).
4/ For more information, see: Process maps for microinsurance operations (FAO, 2012).
ENABLING ENVIRONMENT

Challenge 7
Adequate risk data are not available, not of the required quantity or quality, or are expensive to get for index insurance purposes. Weather stations and other data systems are ill-equipped or non-existent. Good index insurance product design depends on data that are accurate, timely and sufficiently granular to capture homogeneous risks at the local level. Adequate historical and contemporary risk data on crops, yield and/or livestock are required – depending on the insurance product. Even with new products based on remotely sensed/satellite data, some level of ground data is still necessary.6

Solution
Fund public data collection, management and provision (including weather, yield, livestock and remotely sensed data).

Consider linking different data institutions (i.e. meteorology; agricultural statistics; remote sensing) or creating one data centre. This should benefit risk management beyond agricultural insurance; but make sure that any improvements meet the requirements of agricultural insurance and will make data available for these purposes.

Possible approaches include:
  - Supporting additional research and development activities to improve the potential of remote sensing for index insurance.
  - Making further investment in ground data collection protocols, capacity and systems for both crops and livestock (e.g. for forage or electronic tagging).
  - Combining different remote sensing approaches, dedicated mapping tools, and ground-level sources of data and information to improve the quality of index insurance structures.
  - Supporting future initiatives to focus on developing proper segmentation of the size of the insured area, based on agroecological zoning.
  - Planning measures aimed at mitigating the occurrence of basis risk events.
  - Building the capacity of private and public institutions in order to fill current gaps in information to improve the quality of index insurance structures.

Challenge 8
The enabling environment is not conducive to the development of agricultural and climate risk insurance options for smallholder farmers.

Solution
Provide support to government for the setting up or implementation of agricultural insurance products and schemes.

At the policy level, the improvement or design of an agricultural insurance scheme is a major task and may be supported in partnership with multiple donors. This could include interventions that finance:
  - Collection, management and availability of quality weather and satellite data.
  - Development of a strategy for subsidization of insurance in line with good practices, for example by advising on targeting for subsidies and on how to create a level playing field for commercial insurers (such as through setting up an insurance pool – a consortium of insurers eligible to offer subsidized products).
  - Capacity development for key government decision-makers and the technical staff who are responsible for policy and scheme oversight.
  - Coordination between relevant ministries and departments.
  - A monitoring and evaluation strategy, systems and management capacity.

At the regulatory and supervisory level, the government should be supported to:
  - Ensure that adequate safeguards are in place for contract enforcement and transparency.
  - Enforcing contracts that both buyer and seller can trust is a fundamental prerequisite for any type of insurance, but particularly for index insurance. Laws and regulations need to be consistent with international standards.
  - Foster regulatory flexibility to allow innovative products and to enable non-insurance delivery channels. Insurance regulations and supervisory practices should accommodate different types of agricultural and climate risk insurance products, including index-based insurance, and allow delivery channels such as agribusinesses or cooperatives to distribute insurance to their members and clients.

6/ For more information, see: Remote sensing for index insurance (IFAD, 2017).