

SCOPE OF WORK For USE OF USAID Pioneer Prize for Excellence in Science and Technology (IBLI)

Index Based Livestock Insurance Program in Ethiopia: August 2014 – December 2015

BACKGROUND

Recurrent drought has had devastating effects on Borana pastoralists and agro-pastoralists households. Borana pastoralists often employ short term traditional drought coping strategies such as migrating with herds to less affected areas within the Borana Zone and neighboring zones. In addition, they also distribute herds amongst their relatives through customary insurance mechanism like Busa Gonofa. However, the increasing drought incidence in recent years is affecting the whole Borana community thus rendering traditional risk sharing arrangements weakened and insufficient. Mostly the entire livelihoods of the community are threatened since their livestock perish in great numbers during severe droughts.

It is in response to such needs and due to the absence of formal insurance mechanisms in the region that the International Livestock Research Institute (ILRI) in partnership with Cornell University, the Index Insurance Innovation Initiative, Oromia Insurance Company (OIC), Oromia Credit and Saving S.co. (OCSSCO), MercyCorps, Community Initiative Facilitation Assistance (CIFA) and local cooperatives are rolling out an Index Based Livestock Insurance (IBLI) in ten Woredas of the Borana Zone. The product aims to develop this risk management instrument to ensure its commercial viability and its effectiveness in reducing poor pastoralists' uninsured risk exposure; most of whom are illiterate and may have never heard of commercial insurance.

IBLI is a commercial insurance product developed by scientists and researchers at ILRI and Cornell University from satellite imagery of vegetation called Normalized Differenced Vegetation Index (NDVI). Contract holders receive payouts when forage condition deteriorates below a certain historical level. Pastoralists purchase an annual contract with the possibility of payout in either March or October. Payouts are made when the forage situation is below the worst 15 percentile. Oromia Insurance Company (OIC) has been the underwriter of the IBLI insurance product since August 2012. MercyCorps has been financially supporting the educational component of IBLI as part of the USAID Pastoralists Areas Resilience Improvement and Market Expansion (PRIME) program since 2013.

OVERALL OBJECTIVE

While there is a history of frequent drought in Borana, since IBLI began sales in Ethiopia in August 2012, there has not been a drought severe enough to trigger payouts to policyholders. ILRI staff and partners in the region have confirmed that the conditions on the ground match the index readings every March and October – forage availability has just been better than average and there are no significant issues with the design and construction of the Ethiopian contract. Even though it is good that pastoral

populations have not experienced significant stress due to drought, the lack of a payout has eroded trust in the product, and perhaps led some pastoralists to question what exactly they purchased. Moreover, while the number of contracts sold has been on the rise, the level of Total Insured Herd Value has been decreasing, i.e. pastoralists are purchasing but they are insuring fewer animals.

With this in mind, in April 2014, representatives from ILRI, USAID-Washington, OIC, and MercyCorps travelled to Borana to get a better sense of the context in which IBLI was being sold and to speak with current and past policyholders. Out of these meetings and discussions, it was made apparent that there is a need for several activities to boost informed demand for IBLI within the marketing support, capacity building and outreach agenda. At the same time, it was recognized that product design needed to be revisited both in terms of improving the value and offering for the current pilot area in Borana, but also in preparation for anticipated interest to expand to other areas, in particular Afar and Somali. As the potential expansion areas are Muslim-dominated, and given the recent interest around the sharia-compliant program in Kenya, it was agreed that efforts to investigate the possibility of a sharia-compliant product and its implication on product design and implementation was important.

Marketing Support, Capacity Building and Outreach

1. Improved Marketing Messages/Tools: Experience has demonstrated that the educational tools that have thus far been applied have met certain challenges:
 - a. It is difficult to control the quality of information that actually reaches the intended recipient
 - b. The current materials are mainly in written format and are therefore weak in making an audio and visual impact upon the pastoralist client.

It is for these reasons that we believe there is a need to create and design new, digitalized audio and video, scripts, posters, and comic cartoons, etc. in Afaan Oromo (coined to Borana dialect) to improve the awareness and visibility of IBLI within the community.

2. Financial literacy Series: Many in the pastoral community have no experience with any insurance product, and it is clear that many still do not understand when there is no payout, why they do not get their premium back. In general, this population would benefit from a financial literacy series that has the following focus:
 - a. How financial Systems work and why people should trust banks and insurance companies
 - b. Similarities and differences between saving and insurance
 - c. Why insurance is risk management tool

These series will be designed to form a foundation upon which extension messages on IBLI will more likely be understood and appreciated. We are planning to develop a radio-based interactive series (of the type we are already considering for our Kenya program) to make the

series more accessible. This will be done in conjunction with local extension workers and other players – such as MercyCorps – engaged in financial service programming.

3. OIC premium refund strategy: Given the lack of a payout, a promotional activity rewarding early adopters who have purchased, re-purchased, and renewed their policies might be advisable to convince the pastoral community that they have not been foolish in purchasing IBLI and build trust in the product. Under this activity, we would work with OIC to design a system whereby they refund a portion of the IBLI premiums received when there is no payout. This strategy would be subsidized by the S&T Funds to begin with, but then the refund would become part of OIC's day-to-day business over a period of 2 to 3 years.

Product Design/Risk Layering

Currently the IBLI-Ethiopia product is a fairly simple NDVI-based 'forages scarcity' contract. As it stands, and relative to the more complex IBLI-Kenya product that predicts livestock mortality on the basis of a calibrated response function, the IBLI-Ethiopia contract has been very well received by the target client and their representatives as its index readings have been generally consistent with the situation being faced on the ground. Currently, however, there is only one standard contract and there has been demand for contracts that cover more risk (pay more often) and also contracts with higher resolution index areas (moving from a Woreda-level contract to kebele-cluster contracts). This will entail more work around product design.

As part of the contract redesign effort we propose to develop a flexible, web-based, rating tool that will generate contracts in any region with a similar population and risk profile (where pastoralism is the primary productive enterprise among the community and drought-risk is a serious concern) for which relevant NDVI data is entered. We envision this rating tool to allow individuals to price contracts across a whole range of parameters that include risk exposure, trigger and exit determination, the payout function (and the setting of minimum and maximum payouts) and the like,

Sharia Compliance

Currently, Ethiopian finance regulations do not allow for incorporation of a strictly Islamic finance entity. However, they do allow for the development of sharia-compliant windows or products. Discussions with the CEO of OIC indicate that they have commenced a process to set up a sharia-compliant window and we shall also be investigating others who may already be offering other types of sharia-compliant insurance products or have the interest to. Since many pastoralists in Ethiopia (and elsewhere in the Horn of Africa) are Muslim, the successful scaling of the livestock insurance product will require adaptation for compliance with sharia law. Assistance will also be provided to the participating organization to conduct outreach, education and marketing of this

adapted product. This will go along with any efforts to scale beyond that currently targeted Borena zone.

General Budget

(as attached)