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# CEO Risk Forum

# Which way is up?

## Insurers in search of a new direction

Reactions

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# INSIDE

# DRIVING UP AFRICA'S INSURANCE PENETRATION

**Corneille Karekezi**, group managing director and CEO of Africa Re, explains how new technology and indexed based products are stimulating insurance take-up in Africa

With the exception of the past four years, Africa's economies have enjoyed exceptional growth since the turn of the century. The outlook is favourable even though the projected growth falls short of past trends.

However, the economic expansion has not yet translated into equal insurance growth and penetration is still low. This is particularly true for agricultural insurance, which is essential in improving the resilience of Africa's farmers – who still represent 60% of the continent's work force – against weather related events.

Technological change and index-based insurance products open up new avenues to provide protection. Reinsurers, with their expertise and experience across the continent and beyond, can help to spread these products - as a recent initiative of Africa Re with its founding investor, the World Bank, demonstrates.

Africa had an average real annual growth rate of 5.4% from 2000 up until 2010. Due to falling commodity prices, weaker global demand and the impact of political instability growth slowed to an average real growth of 3.3% for the years up to 2015, according to the McKinsey Global Institute (MGI).

Although growth fell to 2.2% in 2016, it is expected to recover in 2017 and 2018 to an estimated 3.4% and 4.3% respectively, according to the African Economic Outlook. The decline was most pronounced in the oil exporting countries and in the Arab Spring countries. With the exception of these markets, the bulk of the African countries maintained stable growth of around 4.5% since 2010.

According to the World Economic Forum, three trends continue to fuel Africa's growth. First, a young and growing population and workforce will add impetus. By 2034 Africa is expected to have the world's largest workforce of 1.1 billion people.

Secondly, the continent will continue to urbanise. Its middle class, currently standing at approximately 350 million people, will expand and its consumption will outpace GDP growth.

Thirdly, technological change will further accelerate growth, reduce costs and enhance productivity. East Africa is already the world leader in mobile payments. By 2020 Africa's smartphones penetration will be at least at 50%, up from 2% in 2010. In addition to these mega-trends, spending on infrastructure, which already doubled over the past decade to 3.5% of GDP, will continue to outpace GDP growth.

### Insurance growth lagging behind

These strong underlying factors impact the growth of insurance. Due to the depreciation of local currencies against the US dollar, in 2016 premium volume stood at only US$60bn, down from US$64bn in 2015, according to recent figures from Swiss Re. In local currency, the year-to-year comparison is positive for key markets, however. (Although South Africa's premium volume, by far Africa's largest insurance market, declined.)

The continent's insurance penetration remained at 2.8%, considerably below the world's average of 6.3% and highlighting Africa's potential to catch up, in particular, as international investments in the continent are driving the demand for insurance. In addition, awareness to insure against natural disasters is rising. And finally, insurers are benefiting from positive changes to regulation and the compliance systems.

Of particular importance for Africa's economies and societies is the continent's agricultural sector. Most of the growth that Africa experienced in recent years had been driven by higher production of mineral and hydrocarbon resources. The rural areas did not benefit equally, as the World Bank states. Today, agriculture still dominates Africa's economies, accounting for 16% of the continent's GDP and employing roughly 60% of the economically active population, and 70% of the continent's poorest communities.

Agricultural growth and enhanced productivity greatly contribute to reduce poverty while supporting structural transformation and urban transition. As the cost of food declines, it remains accessible for an urban population, secures employment and induces the development of an agro-industry.

In addition, food security reduces the continent's vulnerability to famine and epidemics and will also help to lessen migration and political conflict. While incomes increase, people are able to move out of agriculture into sectors of higher productivity and value-add.

### Agricultural insurance essential

Agricultural insurance is a key precondition to facilitating this process as it contributes to enhancing the resilience of farmers against the impact of natural catastrophes – namely drought and flooding. Africa's farmers – 80% of them smallholder farmers or family-run – are heavily exposed to weather-related events as 95% of the arable land is rainfed.

Agricultural insurance helps to gain access to financing and thus to agricultural inputs, like fertilisers and higher yielding seeds, which ultimately increase productivity. As the International Monetary Fund (IMF) found, structural factors limit many African countries' capacity and capability to respond quickly to natural disasters and strengthen their resilience over time.

Despite its relevance, the penetration of agricultural insurance is still low, however. Many markets know no agricultural insurance or have just commenced with an initial pilot scheme. According to the World Bank, Africa's agricultural premium volume accounts for roughly US$200m, which is less than 1% of the global agricultural premiums of US$25bn, and disproportionately lower than Africa's overall share of 1.5% of the world's total premiums.

Coverage includes crop insurance, which accounts for the bulk of premiums written, as well as livestock, bloodstock, forestry, aquaculture and greenhouses. Broadly speaking, two types of cover exist for crop insurance. The first is traditional, indemnity based insurance coverage.

Secondly, in the more recent past, index-based insurance has gained increasing popularity. It is either area yield-based i.e. based on a yield index, whereby the insurer pays out if the actual yield falls below a pre-agreed guaranteed yield, regardless of the realised yield of the insured farm.

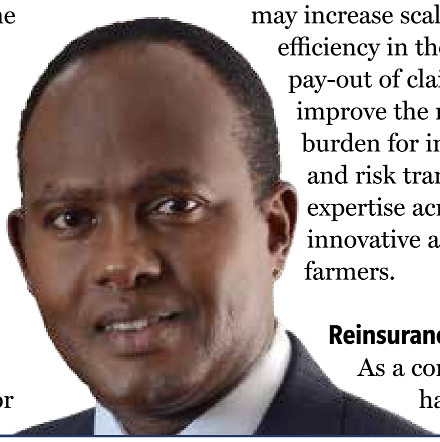
Alternatively, insurers base the index not on the yield, but on the weather, i.e. if the weather index defined, such as rainfall, surpasses or falls short of a predefined threshold, the pay-out is triggered.

**Innovative solutions**

Index-based insurance solutions frequently serve as a basis for micro-insurance solutions, which are an important element in increasing agriculture's insurance penetration in Africa as well as improving productivity in the sector, predominately by limiting the volatility of farmers' income.

Surprisingly though, micro-insurance in the agricultural sector is still in its infancy. According to the Munich Re Foundation and the Microinsurance Centre, in 2014 Africa's micro-insurance premiums amounted to roughly US$750m, with life and credit products being the most popular. Approximately 62 million Africans enjoyed some sort of micro-insurance protection, but just one million people were covered in agriculture.

In an environment where historical data is unavailable and a multitude of smallholder farmers with low sums-insured seek cover, index-based insurance products are very efficient. Pay-outs are based on an index, which do not require costly loss assessment and which can be released immediately after an event. However, for micro-insurance to succeed, it still requires the collaboration of governments, policymakers and private sector investors to provide the regulatory framework and the initial funding to stimulate investments.



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Furthermore, agri-finance or micro-finance institutions as well as technology firms, such as mobile companies, may increase scale, distribution and improve efficiency in the collection of premiums and the pay-out of claims. Reinsurers provide capacity, improve the risk management and reduce the burden for insurers through financial solutions and risk transfer. They provide the overall expertise across markets needed to develop innovative and suitable solutions targeted at farmers.

**Reinsurance facilitates expansion**

As a consequence, more and more insurers have been entering the market recently. Several large-scale programmes like the Agriculture and Climate Risk Enterprise (ACRE), Africa's largest agricultural insurance scheme, insures more than 400,000 smallholder farmers in East and Central Africa; the African Risk Capacity (ARC), a catastrophe insurance pool launched backed by the African Union, has helped to build scale and improve awareness.

In addition, more and more micro-insurance schemes have proven their profitably, and demonstrated that they facilitate access to new streams of income, such as formerly remote risks and client segments.

In February 2017 the World Bank's Global Index Insurance Facility (GIIF) and Africa Re launched a joint risk-sharing facility. The IFC, which had been a shareholder of Africa Re until recently, provided through the Global Index Insurance Facility (GIIF), a significant subsidy to be managed by Africa Re in three pilot countries, Nigeria, Kenya and Rwanda.

By way of an experience account, agricultural insurers in these countries are reimbursed if their annual loss ratio exceeds 75% of their net retained premium. As a result, it is expected that premium rates for insured smallholder farmers will decrease and become more affordable, while encouraging more insurers and regional reinsurers to increase their capacity and expand their agricultural insurance book.

If successful, the pilot project will be expanded to all sub-Saharan countries: overall, Africa Re and GIIF aim to widely broaden the outreach and penetration of agricultural insurance across the African continent within the next ten years.