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Report No: 52850-MN

PROJECT PAPER

ON A

PROPOSED ADDITIONAL FINANCING

IN THE AMOUNT OF
SDR6.3 MILLION (US$10.0 MILLION EQUIVALENT)

TO

MONGOLIA

FOR THE

INDEX-BASED LIVESTOCK INSURANCE PROJECT

January 18, 2010

Social Environment and Rural Sustainable Development Unit
Sustainable Development Department
East Asia and Pacific Region

CURRENCY EQUIVALENTS

Exchange Rate Effective

Currency Unit	=	Mongolian Tugrug (MNT)
MNT1430	=	US$1
US$1	=	SDR0.62105

FISCAL YEAR
July 1 – June 30

ABBREVIATIONS AND ACRONYMS

aimag	Province of Mongolia
bag	The smallest unit of Mongolian public Administration
BIP	Base Insurance Product
CAS	Country Assistance Strategy
CDF	Contingent Debt Facility
CPS	Country Partnership Strategy
DRP	Disaster Response Product
dzud	Extreme winter weather
FIRST	Financial Sector Reform and Strengthening Initiative
FRC	Financial Regulatory Committee
GCC	Government Catastrophe Coverage
IBLI	Index-based Livestock Insurance
IBLIP	Index-based Livestock Insurance Project
IDA	International Development Association
IFR	Interim Financial Reports
ISN	Interim Strategy Note
LIIP	Livestock Insurance Indemnity Pool
LRI	Livestock Risk Insurance
MIS	Management Information Systems
MOF	Ministry of Finance
MNT	Mongolian Tugrug
MoFALI	Ministry of Food, Agriculture and Light Industry
NGO	Non-Government Organization
NSO	National Statistics Office
PAD	Project Appraisal Document
PDO	Project Development Objectives
PHRD	Policy and Human Resources Development Fund
PIU	Project Implementation Unit
PIM	Project Implementation Manual
PPA	Public Awareness and Promotional Activities
PY	Project Year
QAG	Quality Assurance Group
QALP	Quality Assessment of the Lending Portfolio
SDC	Swiss Agency for Development and Cooperation
soum	Rural district
Tugrug	Monetary unit of Mongolia

Vice President:	James W. Adams, EAPVP
Acting Country Director:	Hsiao-Yun Elaine Sun, EACCF
Sector Director:	John Roome, EASSD
Sector Manager:	Ede Ijjasz-Vaquez, EASCS
Task Team Leader:	Andrew Goodland, EASCS

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MONGOLIA
INDEX-BASED LIVESTOCK INSURANCE PROJECT

CONTENTS

MONGOLIA
Index-based Livestock Insurance Project

Project Paper Data Sheet

Date: January 18, 2010 **Country**: Mongolia **Project Name**: Index-based Livestock Insurance Project – Additional Financing **Project ID**: P115119	**Team Leader**: Andrew Goodland **Sector Director/Manager**: Ede Ijjasz-Vasquez **Country Director**: Hsiao-Yun Elaine Sun (Acting) **Environmental Category**: C

Borrower: Government of Mongolia
Responsible agency: Ministry of Finance, United Nations Street 5/1, Ulaanbaatar, Mongolia. **Contact**: Mr. Ulziibold, Director, Project Implementation Unit

Revised estimated disbursements (Bank FY/US$m)

FY	2010	2011	2012	2013	2014
Annual	1.0	2.0	3.0	3.0	1.0
Cumulative	1.0	3.0	6.0	9.0	10.0

Current closing date: June 30, 2011
Revised closing date: March 31, 2014

Does the restructured or scaled-up project require any exceptions from Bank policies?	○ Yes ● No
Have these been approved by Bank management?	○ Yes ○ No
Is approval for any policy exception sought from the Board?	○ Yes ● No

Revised project development objectives/outcomes:
The PDO is revised to reflect the shift from piloting to scaling-up and the focus on building capacity for sustainability. The revised PDO is to ascertain the viability of Index Based Livestock Insurance in Mongolia to reduce the impact of livestock mortality for herders' livelihoods through (i) scaling up Index-Based Livestock Insurance Program in Selected Aimags; and (ii) building the institutional capacity and legal and institutional framework for the sustainability of the Index Based Livestock Insurance Program.

Does the scaled-up or restructured project trigger any new safeguard policies?
Indigenous Peoples OP 4.10

For Additional Financing

[ ] Loan [X] Credit [ ] Grant
For Loans/Credits/Grants:
Total Bank financing (US$m.): $10 million
Proposed terms: IDA Credit (40 years, grace period 10 years)

Financing Plan (US$m.)

Source	Local	Foreign	Total
Borrower	0.0		0.0
IDA CR-4069 (undisbursed)	5.5		5.5
IDA Additional Financing	10.0		10.0
Korean Trust Fund	0.2	0.5	0.7
Swiss Trust Fund	0.2	0.4	0.6
Total	15.9	0.9	16.8

I. Introduction

1. This Project Paper seeks the approval of the Executive Directors to provide an additional Credit in an amount of SDRs equivalent to approximately USD10 million to Mongolia Index-based Livestock Insurance Project (IBLIP; P088816; Credit. No. 4069-MOG).

2. **Summary**: The proposed additional credit would help finance the costs associated with scaling up the project from 4 provinces (*aimags*) up to an additional 17, depending on availability of funds. The performance of the parent project has been satisfactory and has sufficiently demonstrated that a phased scale up is now appropriate to further test viability on a larger scale. At the project's close, the viability of the insurance would be demonstrated by the establishment of a sustainable institutional framework and capacity to operate the scheme, as well as continued willingness of insurance companies and herders to participate. The project would be streamlined based on experiences learned from the parent project however the basic design of the project would remain unchanged, with the exception of dropping the Disaster Response Product (DRP), which, while conceptually sound, has not been widely adopted and needs to be channeled though a different institutional structure. Government Catastrophe Coverage (GCC) would be introduced as a non-commercial portion of the renamed Livestock Risk Insurance (formally Base Insurance Product). The PDO is modified to reflect the shift from piloting to scaling up and building capacity for sustainability. As the proposed Additional Financing may include Indigenous Peoples as part of the scale-up, the Indigenous Peoples policy OP4.10 would be triggered for which an Indigenous Peoples Planning Framework has been prepared and disclosed.

3. **Partnership arrangements**: The parent project is co-financed by a PHRD Grant (US$1.32m) from the Japanese Government, now fully disbursed. A Grant Agreement with funding from the Swiss Agency for Development and Cooperation (SDC) (Swiss Franc CHF800,000) was signed in April 2009, which, in part, replaces a Trust Fund from the Financial Sector Reform and Strengthening Initiative (FIRST) (US$592,000). The latter was cancelled due to the change in FIRST's administration arrangement which put the trust fund under Bank administration and therefore unable to co-finance the project. In addition, a grant from the Korean Trust Fund (US$700,000) has been approved and would cover key international technical assistance costs during the additional financing period.

II. Background and Rationale for Additional Financing in the amount of $10 million.

4. **Project description**: The parent project was approved by the Board on May 26, 2005 and became effective in September 2005. The total loan amount was SDR5.14 million (US$7.78 million equivalent).

5. The current objective of the parent project is to ascertain the viability of index based livestock insurance in Mongolia to reduce the impact of livestock mortality for herders' livelihoods. This would be achieved through i) developing and testing a pilot index-based livestock insurance program in selected *aimags*; and ii) building the institutional capacity and legal and institutional framework for the prospective replication and scale up of the program nationwide.

6. The concept of index-based livestock insurance (IBLI) provides an innovative approach to addressing the high levels of risk in the livestock sector in Mongolia, principally associated with severe winter weather, which is a major contributing factor to rural vulnerability and poverty. The project, based on an index of livestock mortality compiled and maintained by the National Statistics Office (NSO), pilots an approach under which herders purchase policies based on livestock mortality within their local district (*soum*). Under the project, two products are currently being piloted in three provinces (*aimags*[1]). One is a Base Insurance Product (BIP) which is a commercial risk product, sold and serviced by private insurance companies under which herders pay a fully loaded premium rate. This insurance pays out when the local mortality rates exceed specified "trigger" percentages, depending on species and location, up to a maximum exhaustion point. For losses greater than this exhaustion point, a second, DRP kicks in, which is a social safety net product financed and provided by Government.

7. An innovative feature of the insurance program is the institutional arrangements for risk pooling. Given the limited financial capacity of the insurance industry in Mongolia, it would be unable to absorb the potential major losses under the project. Therefore a Livestock Insurance Indemnity Pool (LIIP) has been established, managed by the Project Implementation Unit (PIU) under the Ministry of Finance (MOF), to operate for each insurance cycle. The LIIP has features of both a reserve fund and risk pooling for the insurance companies. The Government offers reinsurance at an actuarially fair price on the exposure beyond a stop loss for the LIIP of 105 percent (to increase to 110 percent in 2009) of herder premium deposited. A Contingent Debt Facility (CDF), financed by the IDA Credit, is used to fund any indemnity payments under the BIP if there is a cumulative shortfall in the Government's stop-loss provision and to make payments under the DRP in the event of a disaster.

8. The project also supports a range of capacity building activities, targeted at participating insurance companies, the NSO and the Financial Regulatory Commission (FRC). Support is provided at the field level to promote awareness and understanding of the product to herders. As this is a learning project, there is also a heavy emphasis on monitoring and evaluation, which provides the basis for refining features of the insurance product and implementation of the project in subsequent insurance cycles.

9. **Project performance**: As of October 2009, IBLIP has completed three full insurance cycles[2] (2006, 2007 and 2008 sales), and the fourth cycle has begun. Implementation progress has been good and many of the original performance targets have been met or exceeded (see table below). The original closing date for the project was June 30, 2010. In June 2008, this was extended until June 30, 2011, to allow the completion of the fourth insurance cycle.

10. The sales of BIP have been greater than anticipated: around 2400 policies were sold in all 56 pilot *soums* in 2006 sales year, over 3700 policies were sold in 2007, in 2008, 4047 policies were sold with a premium of approximately US$120,000 and in 2009, 5654 policies for a

[1] Khentti, Uvs and Bayankhongor aimags were the original three pilots. In December 2008, IDA approved the addition of Sukhbaatar aimag for the 2009 sales season.
[2] The insurance cycle for the livestock insurance starts around January of each year, which the commitment of insurance firms to participate. The sales season extends from April to June each year, with the insurance covering the following mortality risk period from January to June of the following year. Indemnity payment calculations, if any, are made in July and payments made by August. Therefore the entire cycle lasts for more than 18 months.

premium of US$136,000. This increases have occurred despite the low triggering of policies and indemnity payments (prior to August 2008 – see below) and also with a declining cashmere price in 2008 and 2009, which limited the cash available to herders. In the 2008 insurance season, high rates of mortality triggered significant indemnity claims, under both the BIP and the DRP. This provided the opportunity to test the indemnity payment mechanisms and also the drawdown of funds from the CDF. These mechanisms proved to be robust and all eligible herders received their indemnity payments by mid August 2008, when MNT389 million (US$340,000) was paid to 1783 herders. Again in 2009, there were significant claims with 2117 herders receiving payments amounting to US$275,700 in total. Two years of successive losses by insurance companies have led to further design modifications, including the introduction of an aimag-level stop loss, to limit losses due to high mortality in individual aimags, which would be priced into the government reinsurance. All four of the current participating insurance companies have expressed interest in continuing their participation for 2010.

Table 1: Key outcome indicators

Outcome Indicators		2006	2007	2008
Number of insurance companies participate in the piloting	Target	2-6	2-6	2-6
	Actual	3	4	4
Insurance products are offered in X% of pilot *soums*.	Target	80%	80%	80%
	Actual	100%	100%	100%
% of herders in pilot *aimags* purchase BIP	Target	3%	4%	5%
	Actual	8.3%	12.8%	13.8%
% of due indemnity payments is received by herders.	Target	-	100%	100%
	Actual	-	100%	100%
% of herders in the pilot area aware of the products	Target	40%	70%	75%
	Actual	81%	80.4%	82.6%

11. Capacity building activities have progressed well. The Management Information System (MIS) software which consists of Data Entry, Portfolio Risk Assessment and MIS components has been developed and proven to be instrumental in implementing the IBLI program and understanding the risk. Capacity building with insurance companies has shown significant progress. The NSO has successfully implemented a mid-year livestock census in all 56 *soums* of the pilot areas in 2006, 2007 and 2008. NSO has also successfully demonstrated that a sample survey replicates the mortality estimates that emerge from a complete livestock census.

12. Implementation progress has been consistently rated as satisfactory. There has been substantial compliance with legal covenants. There are no major procurement issues to report. No safeguard policies were triggered for the original project and there have been no safeguard issues during implementation. Project audits have been completed on a timely basis with no major qualifications. A QAG review conducted in October 2008 as part of the Quality Assessment of the Lending Portfolio (QALP) exercise, rated the project "1" overall, i.e. highly likely to achieve its development objectives. The disbursement rate on the IDA Credit is 26 percent and for the PHRD Grant is 87 percent. It should be noted that the disbursement rate for the IDA Credit can be misinterpreted: US$5 million equivalent of the original US$7.75 million Credit is allocated to the CDF. Drawdown from the CDF is only triggered in the event of high

livestock losses. By end of 2008, only US$142,000 had been disbursed from this US$5 million. From non-CDF categories, the disbursement rate is approximately 71 percent.

13. **Additional Financing Rationale**: With three insurance cycles satisfactorily completed and the institutions and systems tested with payments delivered to eligible herders after weather-related losses, there is sufficient evidence that scaling up the geographical coverage of the insurance is now appropriate. The first years of the project have demonstrated that there is considerable interest from insurance companies and herders to participate in the insurance, and the product has shown to be technically viable. Government remains fully committed to supporting the project and the further expansion of the insurance and in December 2008, formally requested IDA support for scaling up the project.

14. Additional IDA financing is justified as the insurance needs to be tested at a larger scale to establish its longer term viability. Although technically viable, there remain many institutional aspects of the insurance that need to be developed before the insurance can be said to be fully viable and therefore likely to be sustained beyond the project's lifetime. The additional financing would therefore be used to support the scale-up and establishing the institutional framework and institutional capacity to continue to operate the insurance beyond the project's lifetime. Additional funds are also required to increase the CDF, as potential government fiscal exposure will increase as more *aimags* are added.

15. Even with the additional financing, the CDF will not have sufficient funds to fully protect the government's fiscal exposure if IBLI operates nationwide. Nationwide coverage would therefore require either government to establish a contingency fund from state budget resources or other sources and/or some of the government exposure is transferred to the international reinsurance market. Exploration will continue with the IFC, reinsurance firms and other donors to support a national level program. In this respect, the "under-funding" of the CDF provides incentives for government to pursue these alternatives to enable the insurance to operate sustainably nationwide.

16. **Impact of economic crisis**: Since the second half of 2008, the Mongolian economy has been hit hard by the global economic crisis. The drop in prices in Mongolia's main export commodity markets (in particular for copper) led to a large fiscal shock, which the World Bank is helping to address through a Development Policy Credit approved by the Board on June 25, 2009. The rural economy is also suffering, due in large to the drop in the price of cashmere, which is primary source of income for the majority of herding households. In addition, the crisis has impacted heavily on the financial sector and rural credit has largely dried up. There was a legitimate concern that the livestock insurance would be hit by the crisis and in particular that herders would not have the cash to pay for premiums. In the insurance market as a whole, premium revenue is down 40 percent in 2009 compared to 2008. However, for the livestock insurance the 2009 selling season recorded an increase in over 30 percent in sales over 2008. This was partly aided by the development of a Special Purpose Loan, delivered by a local bank, specifically to pay for herder premiums. This would indicate that herders do consider the insurance as a priority investment and increasingly understand and trust the index based insurance product.

III. Proposed Changes

17. **Project Development Objective**. The existing PDO (as stated in the Development Credit Agreement[3]) is "*to ascertain the viability of Index Based Livestock Insurance in Mongolia to reduce the impact of livestock mortality for herders' livelihoods through (i) developing and testing a pilot Index-Based Livestock Insurance Program in Selected Aimags; and (ii) building the institutional capacity and legal and institutional framework for the prospective replication and scale-up of said pilot Index Based Livestock Insurance Program nationwide*." It is proposed to modify this slightly to reflect the move from pilot to scale-up and the need to put in place frameworks for future sustainability. The core of the objective would however, remain unchanged; the project is ascertaining validity of the index-based approach. Although the insurance has worked well at the pilot scale, larger scale implementation would present additional challenges, most notably for institutional capacity. Therefore the revised PDO would be "*to ascertain the viability of Index Based Livestock Insurance in Mongolia to reduce the impact of livestock mortality for herders' livelihoods through (i)* scaling up *Index-Based Livestock Insurance Program in Selected Aimags; and (ii) building the institutional capacity and legal and institutional framework for the* sustainability *of the Index Based Livestock Insurance Program.*"

18. **Institutional and Sustainability issues**: As reflected in the proposed revised PDO, creating the institutional framework for the future sustainability of the insurance will be a key outcome of the scaling up period. There are a number of key challenges associated with achieving this outcome:

(i) Ensuring the accuracy and integrity of the statistics collected by NSO which form the foundation of the insurance scheme. The current model, with a full census performed twice each year would not be cost efficient at the national level. A sample survey approach is being piloted and has successfully demonstrated that accurate data can be collected at lower cost and would actually provided a more cost effective approach to livestock data than the current annual census. Further technical assistance to NSO will be required during scale up to refine sampling methodology and introduce sample surveys initially on a pilot basis and ultimately on a larger scale by the final year (2013).

(ii) *Ex ante* financing to ensure that all IBLI herders are paid even following the worst disasters. High correlated risk and potential severe losses pose a significant financial risk for participating insurance firms and the government. With the current four pilot aimags, the overall exposure is relatively small, though this would obviously increase significantly with national expansion and as noted above the additional IDA funding for the CDF is not sufficient to support a nationwide program. It is recommended to maintain the LIIP though with modifications to increase inter-year reserving and hence smooth incomes of insurance firms. This could ultimately replace the Bank financed CDF, though a longer term solution would combine reserving with the transfer of risk to international reinsurance markets.

[3] Note that the PDO as stated in the PAD uses slightly different wording.

(iii) Proper administration and management of the IBLI program to ensure the integrity of the program. While a PIU has been appropriate and has functioned well to implement the program to date, a structure for a sustainable national program requires that these functions are supported by product sales. It is proposed that an entity (most likely public) be created to perform many of the functions that are currently under the PIU, for example to set premium rates, hold and manage reinsurance accounts, manage the LIIP account and make indemnity payments. The entity would be self-sustaining with operational revenue from an administrative fee tied to the sales of the insurance. The entity would be established under the new Law (see below) to be drafted (and passed) during the project lifetime. Under the AF, support would be provided to government to explore different options for long-term administration of the product.

(iv) Efficient delivery systems to give all herders the opportunity to purchase the products. So far, only one delivery mechanism has been tested – the direct sales of the insurance to herders by insurance company agents. Performance varies greatly between agents and it is clear that alternative delivery mechanisms should be available to herders. These would be developed during the scale-up period and could include group-based insurance and also the selling of insurance through local banks (which have already demonstrated a willingness to reduce credit interest rates to insured herders). These would be tested during the scale-up period. The project would promote participation of additional companies and provide technical assistance to join the program;

(v) Technical knowledge and capacity to sustain the IBLI program. Further increasing the capacity of insurance firms to provide the insurance is critical for the success of the scale-up. The insurance market in Mongolia is still relatively immature and will require additional technical assistance to facilitate scale up. As mentioned above, the NSO will require on-going support for accurate and cost efficient data collection.

(vi) An appropriate legal and regulatory framework. Under the current project, a legal and regulatory framework has been established to enable the piloting of the insurance (under the 2004 Insurance Law, the Civil Code, the Insurance Intermediaries Law and Financial Regulatory Committee Law). However given the nature of the insurance it is agreed with Government that it is preferable and would be more robust to create a separate legal and regulatory framework for a scaled-up IBLI program. This would be developed during the scale-up period and would take into account policy decisions of government on the design and institutional aspects of the product. The law would preferably be in place before the final year of the scale up to ensure sustainability. Note that Government is currently considering this issue and may push for earlier legislation. If so, the team would work with government to ensure the law would provide for transitional arrangement and be flexible enough to accommodate design modifications.

19. **Project components and modifications to original design**: The component titles of the project would be unchanged, albeit with slight modifications. Within the components there would be modifications to reflect: (i) simplification of design and the discontinuation of DRP and introduction; (ii) enhancement of likely sustainability through scaling back or redesigning support activities; and (iii) greater emphasis on institutional capacity and institutional and legal frameworks for sustainability, reflecting the shift from piloting to scale-up. The components and their modifications are as follows.

20. **Component 1. Index-based Livestock Insurance Program.** This remains the core component of the project, under which support would be provided to the scaling up of the insurance. As under the current project, this would include support for: data collection and data auditing to ensure integrity of the NSO statistics; management of individual sales records for herders; Risk assessment for the government and for insurance providers; Management of the pre-paid indemnity pool; provision for and management of the Contingent Debt Facility; monitoring, evaluation, and refinements for the program implementation; and, preparation of all legal contracts to effectively implement the pilot. Even during the scaling up phase, this will continue as a "learning" process. Each year, the performance of the insurançe and the perceptions of key stakeholders feed into a review of the program. Changes are subsequently made to improve the quality and likely sustainability of the product.

21. In addition to these regular design review, during the scale-up period some more substantial changes in this component are proposed:

(i) **Separating the commercial insurance from the DRP:** The most significant proposed design change is to separate the commercial insurance (previously called the Base Insurance Product, but now renamed the Livestock Risk Insurance (LRI) from DRP and end project support for the DRP. There has been relatively little uptake of the DRP (other than automatic qualification), even though it is available just by paying a small administrative fee. Tying DRP and BIP/LRI together has proven to be complex and is likely unsustainable given the very large financial exposure of the Government providing reinsurance for the LIIP and the full payment for the DRP losses. A primary motivation for separating these two programs is therefore to ensure that the Government will have the financing to uphold the reinsurance contract that they have for private insurers who sell the LRI.

(ii) **Introducing the Government Catastrophic Coverage.** In the absence of the DRP, to ensure that policy holders are still insured for losses beyond the LRI exhaustion point (currently 30 percent of livestock in the *soum*), the Government Catastrophe Coverage (GCC) would be introduced. This would be a non-commercial portion of the insurance, financed by government. Unlike the DRP, the fiscal exposure under the GCC would be relatively small (around US$6 million for national coverage, assuming 25 percent participation by herders with 50 percent of livestock value insured) as: i) it would only be for herders who have an LRI policy, and ii) it would only cover the value of livestock insured (the DRP initially covered 100 percent of the value of livestock). Any payments under the GCC would be made directly from the CDF.

(iii) **Geographical scope:** The project was originally piloted in three *aimags*, increasing to four from 2009. The scale up would be gradual, adding several new *aimags* per year. Achieving national coverage would require either additional contingency funds either from government or other donors, and/or, to tap into the international reinsurance market to reduce exposure to the CDF. For 2010, it is proposed to add five additional *aimags* and depending on that experience to add a further six in 2011. The final six *aimags* would only be added if reinsurance or additional contingency funds can be secured by 2012.

(iv) **Data collection:** The project has supported annual mid-year censuses as the basis for calculating livestock mortality. At larger scale this is not cost effective and the project would introduce sample based surveys (which have already been tested under the project) to reduce costs and potentially increase the accuracy of mortality estimates.

22. **Component 2: Promotion and Public Awareness**. It remains critical to raise public awareness among a wide range of stakeholders throughout this project. These stakeholders include herders and herder groups, government officials, insurance companies, commercial banks and other microfinance institutions, NGOs and donor organizations. As under the current project, support would be provided for various media (written, radio, TV, workshops, face-to-face) to increase awareness and understanding of the product. Face-to-face education is the most effective, though considerably more expensive and logistically challenging than other approaches and therefore would be scaled back for the expansion. Inter *soum* and inter *aimag* exchanges, especially of participating herders, would continue to be supported.

23. **Component 3**: **Institutional Capacity Building**. This project would continue to provide support for capacity building of key public institutions that play a key role in implementation. Support under this component would be refocused on sustainability of institutional (including legal and regulatory) arrangements and the capacity of stakeholders (NSO; insurance companies, FRC, etc). The project would support:

- Capacity building to strengthen livestock data systems;
- Capacity building to support development of an appropriate legal and regulatory framework including the development of a livestock insurance law; and,
- Capacity building to the FRC in developing an appropriate regulatory framework for IBLI, including providing assistance in developing prudential requirements and in considering future regulations that may be needed to support IBLI.

24. **Component 4**: **Monitoring and Evaluation.** This component would be unchanged. The objective will be targeted at stakeholders during the project to determine how the new products modify their behavior. The focus shall be research oriented to learn, *inter alia*, if the modified behavior contributes to improved risk mitigation, better access to bank and non-bank services, more collaboration among herders, and development of the insurance sector.

25. **Component 5: Project Management.** This component would continue to support the Project Implementation Unit (PIU) to enable the unit to function effectively and provide adequate management for the implementation of the project. Support will include operational costs for the PIU, technical assistance and training for project staff, monitoring and evaluation of operational aspects of the pilot, information dissemination, communication and auditing.

26. **Project costs:** Table 2 below reflects the updated costing and financing plan. The proposed revised expenditure category allocations are included in Annex IV.

27. **Implementation Schedule and Closing Date:** The final sales season under the project would be 2012, with that insurance cycle completed by August 2013. The project closing date would be extended until March 2014: a 2.75 year extension from the current closing date.

Table 2: Project Cost Summary (USD 000)

Component	IDA Credit 4069 (undisb.)	IDA Add. Finance	Korea TF	Swiss TF TF94002	Total
Component 1. Index-based Livestock Insurance Program (not incl. CDF)	0	1,176	266	0	1,442
Component 1: CDF only	4,953	6,395	0	0	11,348
Component 2: Promotion and Public Awareness	12	950	0	0	962
Component 3: Institutional Capacity Building	20	0	55	600	675
Component 4: Monitoring and Evaluation	46	0	349	0	395
Component 5: Project Management	518	1,479	30	0	2,027
TOTAL:	**5,549**	**10,000**	**700**	**600**	**16,849**

IV. Consistency with CAS or CPS

28. The project is fully consistent with the country strategy. The original project was conceived and designed under the 2004 Country Assistance Strategy for Mongolia which expired at the end of FY08. The project was aligned with CAS Objective 2: "Reducing Vulnerabilities". A draft new Country Partnership Strategy proposed continued support for IBLIP under a pillar on "Improving Rural Livelihoods and Environment" including a focus on rural vulnerability. However, in response to the urgent and emerging needs of the economic crisis, in May 2009 an Interim Strategy Note (ISN) for CY2009-2010 (Report No. 48311-MN) was reviewed by the Board. One of the strategic priorities in the ISN is to continue to address rural vulnerability, including through the increased access to financial services such as insurance through, inter alia, additional financing for IBLIP.

V. Appraisal of Restructured or Scaled-up Project Activities

29. **Economic and financial analysis** The multi-period herd model simulation used for the IBLIP appraisal in 2005 was reviewed as to the validity of the models initial assumptions and its appropriateness as a methodology. A review of the initial assumptions of the multi-period herd

model indicates that they are still valid. In the absence of the ability to conduct a traditional financial and economic analysis of the IBLIP, as identified at appraisal in 2005, the multi-period simulation model methodology is still deemed an appropriate method to obtain an insight into the effect of the IBLIP on insured herders. The 2009 analysis corroborates the 2005 analysis at appraisal which was based on six selected *soums*. Both analyses show that when *dzud* mortality rates are relatively high, an insured herder is likely to have a higher yearly income over the long term than an uninsured herder as well as a higher ending herd value. A further benefit is the smoothing of herders' incomes. Furthermore, the insured herder is able to do this with a decreased herd size because the IBLI insurance can substitute herders current preference to increase herd sizes as their approach to risk mitigation. This may have the long-term effect of keeping the livestock size consistent with the long-term carrying capacity of the range as well as increasing environmental benefits.

30. **Technical:** The design remains largely unchanged from the project's original appraisal. During the course of implementation, there have been a number of refinements to the insurance policy in response to feedback from the herders, insurance companies and administrators, and these will likely continue throughout the implementation period. The decision to discontinue the DRP is justified. The project has demonstrated that the DRP is a technically viable approach to post-disaster relief. However, it has been clear that the current project institutional arrangements are not well suited to provide continued support to the DRP, which needs to be viewed in the context of the country's disaster management system, rather than commercial insurance.

31. **Fiduciary:** The financial management assessment update concluded that the additional financing would meet the Banks financial management requirements. The financial management system established under the project is satisfactory and has consistently provided accurate and timely information on the status of the project in the agreed formats.

32. The PIU has demonstrated satisfactory capacity in procurement. A review of the procurement under Additional Financing concludes that the overall risk from the procurement process is average. A procurement plan for the first 18 months of the additional financing has been discussed and agreed with the borrower. The Procurement and Consultant Guidelines version of May 2004, as revised October 2006 will apply to this Additional Financing operation.

33. **Social:** There are over 30 different ethnic groups in Mongolia, of which the Khalkh are the majority of the total population (80 percent). Under the preparation of the Second Sustainable Livelihoods Project (P096439), approved by the Board in June 2006, which is nationwide in geographical scope and targets all herding households throughout the country, a Social Assessment conducted concluded that only one of these ethnic groups meets the Bank definition of Indigenous Peoples: the Tsaatan reindeer herders in northern Hovsgul Aimag. As the proposed additional financing may include Hovsgul, the Indigenous Peoples Policy OP 4.10 would be triggered. As a result, an Indigenous Peoples Planning Framework has been prepared. This was disclosed locally on February 21, 2009.

34. In addition to the Tsaatan, the project would also likely include western provinces where significant Kazakh populations reside (in particular in Bayan-Olgii Aimag). Although not distinguished from the Khalkh majority in terms of herding and livelihoods practices, they are

distinguished in terms of language. All relevant project materials would be translated into Kazakh for project activities in those areas.

35. **Environment issues**: The environment category of the project remains "C". The design of the project is unchanged and the conclusions from the parent project safeguards review remain valid. The Additional Financing is not expected to have an adverse environmental impact. The monitoring system will monitor changes in herder behaviour resulting from the availability of the insurance that may impact natural resources.

VI. Expected Outcomes

36. By the project's closure, if successful, the elements would be in place for the Base Insurance Product to continue to be offered to herders preferably nationwide. The key indicators for this would be the same as in the current PAD, ie: the insurance sector indicating its intention to continue to offer IBLI products beyond the lifetime of the project. This would be influenced by: Government demonstrating commitment to the LRI through adopting an appropriate enabling institutional framework (including legislation); the percentage of herders purchasing the BIP (at commercial rates); the identification of mechanisms for transferring risk out of the country; and, the number of insurance companies participating. The second set of indicators concerning the DRP would be dropped as DRP would be discontinued.

37. One of the indicators from the original Results Framework will be modified as follows: Component 3 – the current indicator "Cost effective new methods for NSO livestock data collection and statistics tested", would be replaced by "Number of *soums* implementing cost effective new methods for NSO livestock data collection and statistics". Target values in the Results Monitoring framework have been updated (Annex I). All other indicators remain valid. No new indicators would be added.

VII. Benefits and Risks

38. **Benefits.** The primary beneficiaries of the project, including under the proposed Additional Financing, are herder households, which stand to benefit from reduction in vulnerability to external shocks. Participating herders are also benefiting from increased access to credit from commercial banks. Secondary beneficiaries include insurance firms, which have and will continue to receive training on core insurance skills, such as actuarial, improving their overall business. NSO also benefits from capacity building and introduction of new methodologies which can be extended to other data sets.

39. **Risks**. At the Appraisal of the original project, there was considerable uncertainty whether (i) insuring companies and herders would actually participate in the project; and (ii) whether the institutional mechanisms under the project would be robust (including data collection by NSO); and (iii) that there would be an opportunity to test the system during the project period (ie. severe weather). Overall risk rating was Substantial. The project successfully mitigated all risks: the promotional and public awareness campaigns have contributed to high herder awareness and participation; the product was structured in a way to make it attractive to insurance firms; support to the NSO has helped to ensure reliability of the data; and finally, the

geographic spread of pilot *aimags* helped to increase the chances of testing the insurance after severe weather, which occurred in 2008 and 2009.

40. Scaling up and building institutional structures and capacity for sustainability present new challenges and risks, summarized in the table below. The current commodity downturn has had a significant impact on the Mongolian economy and herder households. During these difficult times, there is a risk that momentum in project implementation could be lost. Even a temporary withdrawal of insurance firms, or decline in government commitment, could damage the credibility and long term prospects of the insurance irreparably.

Risks	Risk Mitigation Measures	Risk Rating with Mitigation
To project development objective		
Insurance companies may decide to withdraw for the project, temporarily or permanently, for instance due to: (i) current financial crisis results in financial stress or shift in priorities; (ii) if significant losses are suffered, especially in successive years; (iii) they are unable to attract reinsurers to the market; or (iv) profitability of the product declines (due to increased administrative costs, low herder participation etc.)	The project was designed to limit the risk to participating insurance companies, though during the additional financing period they would assume more risk (ie raising the stop-loss trigger point). At the same time, the project would support efforts to attract the reinsurance market to the product.	S
Additional resources and/or access to reinsurance market will not be available to support national level operation of the insurance.	Government and insurance firms have visited international reinsurance firms, which have expressed interest in the project. Discussions have also been initiated with the IFC to explore options for its entrance. Failing this, donors would be approached for additional funds.	S
Herder participation rate decreases (for example due to lack of awareness, high costs; lack of funds due to low commodity prices; or loss of confidence in the product)	Public awareness and promotional activities (PPA) will continue, albeit gradually scaled back. Awareness of product will be monitored as will reasons for not purchasing the product and this information will be used to change, where appropriate, product design or PPA activities. The project will continue to work with the financial sector and regulatory bodies to enhance links between the insurance and credit market, making it more attractive to herders.	M
Administrative costs (including data collection) of the project when operating at scale are unsustainable.	During the additional financing period, the product will be further streamlined, including the introduction of cost effective data collection and analysis. Furthermore, administrative costs will gradually be loaded into the insurance premium.	S
Legislative framework will not be developed by the end of the project or will be developed in a manner inconsistent with the project design.	Work has already begun with the Project Steering Committee, PIU and Financial Regulatory Commission to start a dialogue on the legislative requirements.	M
Overall risk rating		**S**

S – Substantial; M – Moderate;

VIII. Financial Terms and Conditions for the Additional Financing

41. The Additional Financing would be funded from an IDA Credit with standard terms and conditions: 40 years with 10 years grace.

ANNEXES

Annex I:	Revised Results Framework
Annex II:	Revised Results Monitoring
Annex III:	Financial Management and Disbursement Arrangements
Annex IV:	Revised costing and Expenditure categories
Annex V:	Project Team

ANNEX 1

Results Framework - Revised

PDO	Outcome Indicators	Use of Results Information
To ascertain the viability of index-based livestock insurance in Mongolia to reduce the impact of livestock mortality for herders.	Insurance companies indicate intention to continue/expand LRI after the lifetime of the project. Legislation passed institutionalizing and regulating index based livestock insurance in Mongolia. International reinsurance market participates in the product and assumes some of the risk.	PY8: Government and insurance companies review results from project to determine viability of IBLI.
Intermediate Results One per Component	**Results Indicators for Each Component**	**Use of Outcome Monitoring**
COMPONENT 1 Index based livestock insurance functions in selected *aimags*.	COMPONENT 1 Number of insurance companies participating in IBLIP . Percentage of total *soums* in selected aimags offering IBLI. Percentage of total herders in selected aimags in contact with insurance agents offering LRI. Percentage of total herders in selected *aimags* purchasing LRI. Participating insurance companies provide 100 percent of contractual payments into LIIP and Government BIP reserves when required. Percentage of total indemnity payments received by herders.	COMPONENT 1 PY2-7: low levels (i.e. one or two) of insurance company participation may flag revision of eligibility criteria. PY2-7: low levels of product coverage, outreach and uptake may flag obstacles to product design and delivery requiring further investigation. PY 2–8: failure to provide required payments may indicate the need to strengthen contract sanctions. PY 3-8: incidences of herders not receiving payments will require urgent follow-up from PIU.

COMPONENT 2 Herders can make informed decisions on purchasing LRI.	**COMPONENT 2** Percentage of total herders in the pilot area aware of the products. Percentage of total herders in the pilot area receiving information from project public awareness teams.	**COMPONENT 2** PY2-5: low levels of awareness may flag need for strengthening public awareness activities.
COMPONENT 3 Institutional framework and capacity in place to implement IBLI in Mongolia.	**COMPONENT 3** Legal framework for IBLI drafted and enacted. Number of *soums* implementing cost effective methods for livestock data collection and statistics. Mechanisms for transferring risk out of the country identified. Number of insurance company underwriting staff certified in IBLI.	**COMPONENT 3** PY5: lack of regulation would inhibit continuation / expansion of IBLI . PY5: failure to introduce effective new approaches to livestock data systems would limit continuation / expansion of IBLI . PY5: lack of re-insurance market interest may be linked to capacity of insurance firms and/or legal framework. PY 2-7: low levels of certification may flag need for increased training.
COMPONENT 4 Information available on the performance, outreach and impact of IBLI.	**COMPONENT 4** Number of annual monitoring reports and impact assessments (including post-*dzud*) published. Number of herder interviews conducted. Number of dissemination workshops held.	**COMPONENT 4** PY2-8: failure to publish monitoring reports or to conduct sufficient numbers of herder interviews or dissemination workshops may indicate review of data collection, analysis and dissemination methodology and MIS team capacity.
COMPONENT 5 Project implemented by PIU.	**COMPONENT 5** Timely implementation of component activities, including management of the insurance accounts and indemnity payments. Compliance of implementation with legal documents (including flow of funds, procurement and auditing).	**COMPONENT 5** PY1-8: failure to implement project as stated in PIM and in accordance with Bank procedures may flag need for PIU capacity building.

ANNEX II

Results Monitoring - revised

		Target Values					Data Collection and Reporting		
Outcome Indicators	**Baseline**	**YR4**	**YR5**	**YR6**	**YR7**	**YR8**	**Frequency and Reports**	**Data Collection Instruments**	**Responsibility for Data Collection**
Number of insurance companies indicate intention to continue/ expand LRI after end of project. Government's commitment to IBLI through adopting enabling legislation.	Not applicable	n/a	n/a	n/a New law passes	n/a	2	Final evaluation report will indicate viability of LRI and DRP (based on insurance companies and government responses).	Workshops	PIU
Results Indicators for Each Component									
Component One : Number of insurance companies participating in IBLIP.	4	4	4	4	4	n/a[7]	PY4, 5, 6, 7 – contracts signed with Government.	Contracts	PIU
% of total *soums* in selected aimags offering IBLI.	100%[4]	80%	80%	90%	90%	n/a	PY4, 5, 6, 7– annual monitoring report.	Herder surveys, insurance business plans.	PIU, insurance companies
% of herders in contact with insurance agents offering LRI.	68%	60%[5]	60%	60%	60%	n/a	PY4, 5, 6, 7– annual monitoring report.	Herder surveys	PIU

[4] Note that the addition of new aimags is expected to lower percentage of soums offering the insurance

[5] Note that target is lower that baseline as the impact of adding new aimags each year will affect overall figures

% of herders in selected *aimags* purchase LRI .	14%	15%[6]	15%	15%	15%	n/a	PY4, 5, 6, 7– annual monitoring report	Herder surveys	PIU
Participating insurance companies provide contractual payments into LIIP and LRI reserves as contractually required.	100%	100%	100%	100%	100%	n/a	PY4, 5, 6, 7– project progress reports	PIU financial records	PIU
% of due indemnity payments distributed to *soum*-level institutions (banks, etc.).	100%	100%	100%	100%	100%	100%	PY6, 7, 8 – post-event indemnity response report	PIU financial records	PIU
% of due indemnity payments received by herders.	100%	100%	100%	100%	100%	100%	PY6, 7, 8 - post-event indemnity response report	PIU financial records, herder surveys	PIU
Component Two : % of herders in the selected area aware of the products.	80%	80%	80%	80%	80%	80%	PY1-8 – annual monitoring reports	Herder surveys	PIU
% of herders in the pilot area receiving information from project public awareness activities .	50%	50%	50%	50%	50%	50%	PY1-8 – annual monitoring reports	Herder surveys, PPA team reports	PIU
Component Three: Regulations for IBLI drafted.	None	-	Yes	-	-		PY5 – draft regulations	n/a	PIU, Financial Coordination

[7] Note: final year the insurance will be offered under the project will be Year 7, so no project target is included. However, it is expected that if successful, insurance companies would continue to offer the insurance in Year 8.
[6] Note: this remains flat through the project: new aimags generally have lower adoption rate, and overall target rate reflect the impact of adding new aimags each year.

									Committee
Number of *soums* where cost effective new methods for NSO livestock data collection and statistics introduced.	None	40	80	120	160	200	PY1-8 – project progress reports	Consultation with NSO	PIU, NSO
Component Four: Number of annual monitoring reports and impact assessments (including post-event) published.	None	1	1	1	1	1	PY1-8 Reports	PIU records	PIU
Number of herders interviews conducted.	None	1000	300	1300	300	1000	PY1-8 Project M&E reports	PIU records	PIU
Number of dissemination workshops held.	None	0	4	4	4	6	PY1-8 project progress reports	PIU records	PIU

ANNEX III

Financial Management and Disbursement Arrangements
Additional Financing for Index-Based Livestock Insurance Project

1. The financial management arrangement of the existing project was previously assessed and deemed acceptable in February 2005. The assessment for the additional financing has concluded that the project will continue to meet the minimum Bank financial management requirements, as stipulated in BP/OP 10.02. The FM risk rating proposed for this project remains moderate.

2. No outstanding audit issues exist with the existing PIU who will continue to be responsible for the proposed additional financing. The Bank's audit requirement will not change due to the additional financing.

3. The IDA additional financing proceeds will continue to use the existing designated account (DA) for the on-going project, and the Recipient has further undertaken that, to the extent possible, the proceeds of the additional financing will be utilized upon the exhaustion of the funds available under the original credit for the financing of the respective eligible expenditure. A separate DA will be opened for the Swiss and Korean grant respectively. Note that the Government of Mongolia has decided to use the treasury system for disbursement of the IDA funds under this project. The IDA DA will be moved into the Bank of Mongolia and managed by the MOF – Treasury Department. The eligible expenditures under the project will be paid from the treasury account and then the equivalent USD amount will be deducted from the DA to reimburse the treasury account on a daily basis. This change has been reviewed by the FMS and is considered reasonable.

4. The FM institutional arrangement will remain unchanged. The existing PIU, which has been managing the existing Bank's project for over 3 years, will continue to manage the additional financing. The PIU's performance thus far has been satisfactory.

5. Procedures of proper authorization for payment request, segregation of duties, safeguarding assets and timely preparation of reliable financial information based on accurate accounting records will remain the same with the exception of the change noted in paragraph 3 above.

6. The same accounting policies and procedures of the existing project will be used for the additional financing. FM manual has been updated to integrate the specific requirements of the additional financing. The FM manual has been reviewed and agreed to by the Bank.

7. The format of the Interim Financial Reports' (IFRs) will remain the same as agreed to under the existing project. The PIU will continue to prepare the IFRs including the original credit and the additional financing and submit the reports to the Bank for

review on a semi-annual basis within 45 days after the end of each semester (prior to August 15 and February 15 of each calendar year).

8. In accordance with the Bank requirements, the project annual financial statements will be prepared for combination of existing project and the additional financing. The annual audit report on the project financial statements will be due to the Bank within 6 months after the end of each calendar year.

9. Please refer to FM assessment on file for detail discussions.

ANNEX IV

Project costs by expenditure category (USD)

Category	Original allocation CR4096	Amount undisbursed CR4069	Additional Financing (total $10m)	Total (to be disbursed)	% of Expenditures to be Financed
Consultants' Services under Part A, D.1, D.2, D.3, D.4 of the project	237,601	46,509	1,150,000	1,196,509	100%
Goods and Services other than Consultant's Services under Parts B, D.1, D.2, D.3, D.4 and E of the project	144,144	-47,097	703,000	655,903	100%
Training, workshops and study tours under Parts A, B, D.1, D.2, D.3, D.4 and E of the project	126,720	-19,763	140,000	120,237	100%
Contingent Debt Facility under Part A.2 of the Project	5,258,913	4,953,281	6,390,000	11,343,281	100%
Public awareness campaign under Part B of the Project (except goods and training)	871,205	12,462	945,000	957,462	100%
Consultants' services for Project management under Part E of the Project	1,061,286	404,599	468,000	872,599	100%
Incremental Operating Costs	380,162	179,898	204,000	383,898	100%
Goods under Part C.1 of the Project	61,776	19,503	0.00	19,503	100%
Total	**8,141,807**	**5,549,392**	**10,000,000**	**15,549,392**	

ANNEX V

World Bank Project team

Andrew Goodland	EASCS	Task Team Leader, Agricultural Economist
Gayane Minasyan	EASRE	Co-Task Team Leader, Environmental Economist
Olivier Mahul	GCMNB	Program Coordinator, Insurance for the Poor
Erdene Ochir Badarch	EASCS	Operations Officer
Dong Yi	EAPCO	Senior Financial Management Specialist
Martin Serrano	LEGES	Counsel
Chaogang Wang	EASCS	Senior Social Scientist
Gerelgua Tserendagva	EAPCO	Procurement Analyst
Dulguun Byambatsoo	EACMF	Short term consultant (FM)
Minhnguyet Le Khorami	EASER	Program Assistant
Lourdes Anducta	EASER	Program Assistant