INTRODUCTION
Insurance is rapidly gaining popularity as an additional financial tool to help people living with poverty coping with the risks and vulnerabilities they face in everyday life. Saving is the traditional way to deal with such risks whereas borrowing comes in to strengthen income earning capacity or stabilise family incomes. Insurance extends the coping capacity to a next level of leverage as it increases the scope of risk coverage.

The growing popularity of insurance as an additional coping tool can be explained in various ways. Established insurance providers are continuously looking for expansion of their activities and have made inroads into the lower segments of the market. Development organisations are looking for ways and means to support their target groups in strengthening their coping capacities. Microfinance institutions develop new financial products and services to meet increasing client demand, and donor agencies are supporting policy and practice changes towards a more inclusive approach of financial service delivery to contribute to the realisation of the Millennium Development Goals.

Moreover, in the last ten years a good deal of pioneering and experimentation in the field of microinsurance has been conducted, which resulted in a growing confidence that insuring poor people is actually possible. As microfinance has shown that the poor are bankable, microinsurance is showing that they are insurable as well. The same experience is also showing that they are not insurable just like that. Risk levels are high and risks are difficult to assess. The longer term horizon of insurance benefits may not always be easy to digest or appreciate by clients living in a day-to-day survival environment. Exclusion of high-risk clients is part and parcel of the insurance system, which may undercut solidarity based development approaches. And some clients tend to benefit more from insurance schemes than others, though all have to pool the same resources to keep the system going.

The experimentation of the last ten years has seen failures as much as success stories. Careful analysis of both has resulted in a body of literature, manuals and guidelines that carries the sector further. Clear don’ts have been identified, while do’s are gaining wide acceptance across the sector. This contributes to the development of a policy framework that, though still being work in progress, already shows potential for bringing various actors and parties together to enhance insurance delivery to the poor in a rather substantial, if not spectacular way.

The single most crucial element of this policy framework is the recognition that successful microinsurance must be demand based. Demand for insurance should come from the clients, the poor; should not be pushed upon them by insurance companies, NGOs, MFIs or funding agencies. Acceleration of the sector, in other words, must be generated by the clients themselves if it is to succeed.
This also requires recognition of the fact that blue print approaches are likely to poor people faces different risks and challenges. Acknowledgement thereof presupposes a substantial handling capacity on the part of insurance deliverers in terms of tailor-making their products to the specific conditions of their clients. Microinsurance, therefore, is not a financial service that should be introduced lightly, or be considered as a side activity.

This paper aims to present an overview of the current state of affairs of the micro-insurance sector. Following the demand based condition for success it starts with a client perspective: how do people living with poverty cope with their risks and what roles can insurance play in those strategies? Then it discusses how service providers can perform those roles and subsequently it looks into the supportive role of funding agencies, investors, technical assistance providers, reinsurance companies and others agreeable to sustain the growth of microinsurance. This way, the paper presents the sector from three perspectives: clients, providers and supporters.

Since insurance in some ways is fundamentally different from banking, it will also briefly go into the more technical details of insurance without, however, becoming a technical guide as those already exist.

This paper was written at the request of the Microinsurance Association Netherlands, MIAN, in order to present an overview of current insights and practices in the sector to its own member organisations, and with financial support from Novib/ Oxfam Netherlands.
1. COPING MECHANISMS

People living with poverty, throughout the ages, have developed mechanisms to deal with risks affecting their lives. These are essentially the same as the risks faced by better-off persons: illness, death, disasters, loss of property, and loss of income earning capacity. But whereas the better-off have access to sophisticated insurance schemes and often have a financial buffer to overcome temporary set-backs, the poor usually lack both.

In case of shock, they rely on coping mechanisms based on self-insurance: mostly informal and time-honoured group based support systems. These are based on savings or on borrowing models. Ex ante models manage risks before the event occurs, such as in the case of marriage or burial funds. Ex post models manage risks after the occurrence of the event, such as borrowing from family, solidarity groups or money lenders.

These coping models function very well if the impact of the shock is limited; as in the case of theft of a goat or the decease of an elderly member of the family. The costs of replacing the goat or financing the burial are restricted and can often be covered by a loan or from savings respectively.

In their field research in East Africa, Cohen and Sebstad identified a general coping pattern linking direct impact with responses and future impacts. Their model, which is seen from the perspective of a micro-entrepreneur, convincingly shows that traditional coping mechanisms still function well if the stress level of the risk event is limited (low to medium). If, however, the stress level is high, the affected family can not hope to overcome the damage and faces a serious decline of the quality of its life.
And as the authors remark, the very poor have even fewer options. The self-insurance schemes on which they rely are highly inadequate to deal with major risk events. Overcoming the damage often leads to future indebtedness.1

In Southern Africa, for instance, burial funds have performed fairly well for ages. But with the rapid expansion of the HIV/AIDS epidemic many of these funds have become stretched beyond their limits. Members cannot cope any longer with burial cost by setting aside some savings. The high incidence of funerals has depleted these funds and members now have to borrow as well to cover the costs.

In short, then, the growing demand for microinsurance can be explained in terms of looking for new coping mechanisms to deal with high stress risk events. The role microinsurance can play in developing such mechanisms conceptually also defines its role in development. But that role actually extends further following basic economic logic. If people can shield off risks, they can borrow more for investment purposes, and ultimately create more jobs and wealth in their communities. In that sense insurance has an economic acceleration function as well.

The experience of the mutual insurance sector in developed countries indicates a sequence in financial needs. People generally start with developing safe places to put their savings. After a while they tend to start borrowing as well, which increases their liquidity and may lead to further investments in income earning facilities. Insurance extends this liquidity even further, as it keeps risks in check. In developed countries the time lapse between borrowing and insurance was approximately 30 years as regards development of massive demand. The same pattern can be witnessed now in developing countries, although the time lapse may differ from country to country. Microinsurance can thus be seen as sequential follow-up of microcredit.


2. MICROINSURANCE AND DEVELOPMENT

Poor people have different needs and priorities. Designing insurance products on a one-size-fits-all platform runs the risk of neglecting these differences and affecting any insurance programme adversely. An interesting approach to recognise these differences was presented by the Microfinance Centre, the main network of Eastern European and Central Asian microfinance institutions. First it placed insurance needs in the broader context of all problems faced by a potential group of clients. Then it compared different settings; in the box between Uganda and Albania. This way, hierarchies of problems could be identified.

After differentiating as to settings, the approach allows for looking at variances across groups. Women may have a different problems ranking than men as illustrated in the next box, coming from Ghana. Lastly, the approach advocates looking for differences between groups within the same setting. In this example differences are presented between vulnerable and non-vulnerable households in Uzbekistan. Obviously, then, a development-relevant approach of micro-insurance schemes will factor in these differences when designing the most appropriate policies.2

2 Slide show presentation by Michal Matul of the Microfinance Centre for Central and Eastern Europe and the New Independent States at the KfW Microinsurance Symposium, Frankfurt, October 2004.
Apart from needs hierarchies there are other considerations to take into account when it comes to microinsurance. Particularly when addressing the needs of the poorest it is important to take into account past experiences, accessibility, simplicity and timeliness of procedures and necessary education.

As to the last issue, for many poor it is not easy to distinguish between savings and insurance because both require payments before returns or benefits can be collected. And whereas the client keeps a lien on her savings, she can not have the same hold on her insurance payments: these seem to disappear in the scheme beyond her control. It will be up to the scheme, not her, if she ever will see anything back from her investment. After a considerable period of premium payments without receiving any benefits, it is indeed difficult for many to see the virtue of the insurance scheme. It may work, but not for them. And it may get worse when, in case there is a real risk event, the scheme tells the client that this particular risk was not insured.

Many indeed have the perception that that is what the formal insurance companies are all about: taking your payments but not delivering when you need their help to cope with a risk event. Not necessarily because of ill-will, though; the impression is as much based on lengthy claim processing procedures, legal sophistication (the ‘small print’) or high transaction costs on the part of the client. Real as well as legal and financial illiteracy are undeniably difficult hurdles to overcome.

One way to overcome these hurdles is to design both policies and procedures in rather straightforward terms, leaving little room for ambiguity or doubt. Another is to test the products rigorously before formally bringing them to the market. MicroSave sponsored studies have come forward with a useful process definition for the introduction of new insurance products. 3

---

3 Ibid.
That still leaves the issue of high expectations. Basically an insurance scheme cannot pay more for claims than the sum of the premiums collected, minus its administrative and other costs. For clients, at average, therefore benefits are smaller than premium payments. But average benefits do not really exist: some clients submit a claim but most don’t. Unless in cases where many clients are affected at the same time by the same risk event: of man-made or natural disasters. This is known as the covariant risk. That is why scale of operations and geographical coverage are important in insurance. Some villages may be flooded at the same time, but not all villages in a larger area. Clients in non-affected areas may bail out clients in affected areas if the scheme is large enough, especially if the scheme is able to reinsure the collective risk of all its clients and share it with other schemes.

As to more individual products, such as health insurances, the risks are different. BRAC has piloted various health insurance schemes in remote areas in Bangladesh. The first pilot showed that the scheme did not work too well because of lack of sufficient and convenient access to health facilities. Clients did pay premiums, but couldn’t find doctors when they needed them. In the next phase BRAC decided to put such health facilities in place itself. That solved the access issue, but created a new one: clients living closer to the medical facilities tended to frequent them more often. Also, more assertive or educated clients tended to make better use of the facilities. This created the risk of the poorest clients in the scheme actually subsidising health services for the slightly less poor or less remote clients. A third phase is now running to address these risks and make the scheme more equitable.

This experience underscores the need for proper research before as well as after the introduction of insurance products.

3. MICROINSURANCE AND MICROFINANCE

The success of microfinance, from a client perspective, can be attributed to two basic features. Whereas most poor have access to informal savings groups, institutionalised microfinance creates a more secure savings environment. Money in a vault is safer than money hidden under a mattress and money saved in a bank brings in some interest as well. Secondly, it created financial leverage by bringing in outside capital to borrow. Many poor, again, already may have had access to credit, but often at high costs of capital. The institutionalisation of low-income credit delivery has created greater access to capital at lower cost.

As more capital becomes available for the poor, beyond the amounts they are able to save collectively, both their fall-back position and their income earning capacity improve. There is access to money to deal with temporary set-backs, which may smoothen their income and reduce vulnerability, and they can borrow to invest in productive activities which may increase their income.

Most microfinance institutions have become involved in various forms of insurance as well. The most wide-spread is the loan insurance. If the borrower dies, her family does not have to repay the outstanding loan. The cost of this insurance is paid for by a relatively small fee at the time of taking the loan. The other major product is life insurance. When a client dies, her family gets a certain amount, the benefit, from the microfinance institution. Premium is paid for by, again, a special service charge, or, even less demanding from an administrative point of view, by paying the claims out of the gross profit of the microfinance operations.

Both products can be fairly easily integrated with the loan administration and many institutions offer these products on a mandatory basis: the insurance is directly linked with loan provision. These products do not represent great risks to the institution.
The scheme is collective, meaning that no single client would feel excluded, it is not very sensitive to fraud or debate, and the risks are not too difficult to calculate.

Other forms of insurance, however, may not be collective, may be sensitive to fraud or interpretation, may be difficult to assess in terms of risk exposure, and may not be so simple to integrate with an institution’s administrative systems. And it is because of the added complexity of these products that the question has been raised if microfinance institutions would do wise to become directly involved in the provision of microinsurance products, other than life and loan.

This question will be addressed in the next section. From a client perspective, it may be useful to reiterate their stakes in being serviced. Insurance essentially provides an added coping mechanism to better deal with risk events. To be serviced efficiently and effectively, insurance provision must be affordable, simple, timely and relevant to their specific risks.

In the absence of reliable government statistics, the institution’s own experience-based data are often enough. Again the case of BRAC: out of the some 4 million members of their groups, approximately 60,000 die every year. At a benefit level of Taka 3000 (Euro 20), BRAC can calculate that it needs to pay approximately of Euro 1.2M every year in benefits, which is debited to the gross profit it realises.
II PROVIDER PERSPECTIVE
1. THE INSURANCE INDUSTRY

Microinsurance is the protection of low income people against specific perils in exchange for premium payments proportionate to the likelihood and cost of the risk involved, to draw on a widely used definition. The technical aspects are not fundamentally different from commercial or co-operative insurance; the setting is though. Microinsurance clients are often more exposed to risk and have fewer back-up facilities to deal with those. That is why the formal sector has traditionally shown little interest in servicing poor clients: they were considered uninsurable.

Insurance arrangements are said to have been in place in major ancient societies. Known is the example of King Hammurabi who lived in the 19th century BC and who set up a system to insure trade caravans. A major conceptual breakthrough is attributed to Pope Gregory IX who, by issuing naviganti vel eunti ad mundinas, in 1237 moved risk management systems from pre-financing to insurance. The formal industry as we know it today dates back to the expansion of the British Empire in the late 18th century and is linked to Lloyd’s of London. Merchants and traders wanted to reduce the risk of their ocean-going vessels and cargos and looked for high net-worth individuals to share the risk in return for a good premium. This was an insurance against natural disasters and hijacking at high seas. Later property insurances were developed such as against fire and theft. Later again life insurance was developed.

The growth of the welfare states in the 20th century gave rise to collective and sometimes mandatory insurance schemes such as for unemployment, illness, disability and retirement. In the meantime, the agricultural sector gave birth to co-operative insurance schemes as crop and livestock policies.

Today nearly all countries in the world have a functional insurance industry. Many people have formal access to all kinds of insurance products, but for more than two billion people this formal access does not translate into actual access. Premiums may be prohibitive, income may be too low or insecure, distance may be a problem or the risks to be insured may be considered too high. In a perfect market situation demand and supply are in balance. For insurance that would mean that virtually anybody can get any risk insured at an affordable rate. Whereas in some parts of the world that market equilibrium is being approached, in most countries the majority of the population still has no actual access to affordable insurance.

This points to a built-in feature of the insurance industry: though insurance is about managing risks, the industry is by nature extremely risk-averse, and to a large extent has to be to stay alive. To explain this paradox, it may be useful to have a look at how insurance works.

---

1 By McCord & Osinde, quoted in Cohen and Sebstad.
2 In Lloyd’s café they added their names under the name of the outward bound vessel on a chalkboard, hence the origin of the words underwriting (taking a risk share) and Names (the risk sharers).
2. THE ART OF INSURANCE

If 1000 people take a loan of Euro 100 at the same time, the service provider has Euro 100,000 exposed. It knows that a certain percentage of its clients may have a problem with repayment. Normally that is well below 5%. The actual risk exposure is thus maximally 5000 only at any time and the institution covers that risk by factoring in this 5% in its interest rates, which, in microfinance, are between 15-25% or even higher. That way, all clients collectively pay for the non-performance of some of them and the scheme is not at great risk.

Though the principle in insurance is the same, ‘all for one’, the risks work out quite differently. Whereas the risk exposure of the microfinance institution is limited and decreases with the gradual repayment of the principle of the loan, in insurance the risk exposure remains at the same high level; it does not decrease.

If 1000 people pay a premium of Euro 10 per year in a health scheme, the insuring agency collects Euro 10,000 in payments. Corrected for administrative and other costs at 30%, the agency would have Euro 7000 available for paying claims to clients seeking health care or medication. If the average costs thereof would be Euro 100, the agency can not help more than 70 clients per year out of the total group of 1000 without actually losing money. If demand would show to be higher or more expensive, the agency has to act: limit the cover of the health package or increase premium payments.

If it comes to crop or livestock insurance, the risks are more volatile. Crop is sensitive to weather conditions and livestock to diseases, including endemics. There is a chance that all clients of a crop insurance scheme may face damage at the same time. If that happens once in ten or twenty years, the agency is likely able to handle the risk; if it happens repeatedly, the agency goes down.

Actuaries are professionals trained in calculating risks and corresponding premiums and in minimising the risk exposure of their agency to keep the system going. The following are common practises in the industry to reduce risk.

• Limitation of cover: often policies contain a maximum amount to be paid, the benefit, in case of a risk event, even though actual damage or costs may be higher.
• Exclusion: persons with a high risk profile may be prevented from entering the scheme, or at higher premium levels only.6
• Deductibles or ‘own risk’: the insurance only starts paying a benefit after the clients have paid a first part of the damage themselves.
• Moral hazards exclusion: a client is not expected to increase the chance of a risk event happening, for instance by negligence.
• Reinsurance: the agency may try to have its own risks underwritten elsewhere.
• Waiting periods: a client must wait a certain period, while paying premium, before the policy becomes effective.
• Proportionate coverage: the actual amount of covered benefit is linked to the past period of premium payment.

6 In health insurance this may affect the elderly but also HIV/AIDS infected clients.
3. DELIVERY MODELS

Direct service delivery by MFIs

A first model is direct service delivery to the poor. This is practised by quite a few microfinance institutions as they are generally the only financial institutions working at the doorsteps of the poor, especially in rural settings. Quite common among these MFIs is the provision of life and loan insurance. Others have moved into health and pension schemes, albeit the last variety mostly for their own employees. Less frequent are property insurance and rather unusual to date are crop and livestock insurance. Or to be more precise: many have tried and many have burned their fingers. In insurance lingo: the exposure to covariance and moral hazard risks may be too large to handle.

The reasons for microfinance institutions to become involved are not difficult to understand: they have a unique distribution system in place already and they witness the growth of demand on a daily basis. Clients may ask for insurance and they do so frequently. So the temptation for involvement is there, but so are the risks.

Some MFIs developed the practice of reinsuring their risk exposure through their loan portfolio. Whereas the exposure of this portfolio is normally limited to non-repayment of loans, in these cases it is added to the risk of having to compensate for insurance losses. This may negatively affect financial prudence of the institution and may run it into trouble with supervisors in regulated settings.

The other potential problem is exclusion or rather the lack thereof. Whereas in microfinance, particularly pro-poorest microfinance, it is common to try to include as many as possible clients to maximise outreach and impact, in microinsurance a more cautious approach is needed. If outreach becomes a goal in its own end, chances have it that too many high-risk clients will be included, or too many high-risk policies will be offered, which may breach the principles of proper risk management.

Despite these risks, there still is a lot to say in favour of direct insurance delivery through microfinance institutions, with

---

These limitations are as common in formal insurance as in microinsurance. For the client to calculate the usefulness of a particular insurance product, it is important that the provider presents a fair overview of limitations and in microinsurance this has led to a simple yet effective range of products. Simplicity is also a key to reduction of transaction costs. All the time and energy spent on debate, interpretation and verification of claims must be paid from both sides and drives up the cost of insurance.\(^1\)

Insurance is based on a number of principles. For microinsurance the following are basic:

- Risk pooling: many people are exposed to the same risk, but not all face risk events at the same time. Covariant risk should be avoided, unless the risk can be reinsured or shared.
- The clients, policy holders, should preferably not be able to influence or control the risk event happening to minimise the dangers of moral hazard and fraud.
- Losses from risk events should be straightforwardly determinable and measurable.
- The chance of a risk event happening should be calculable.
- And premiums should be affordable.

Providers of microinsurance face three sets of specific challenges, relative to the insurance industry at large. Firstly, it requires specialised actuarial capacity in the light of lack of reliable statistical data. Secondly, as explained before, for poor clients the concept of insurance may be quite new or negatively loaded because of past experiences. It often takes time and effort for them to see the potential benefits of insurance. Thirdly, microinsurance is quite demanding in terms of distribution: large numbers of clients paying small premiums for limited coverage is a different ball game than handling few clients paying high premiums for top-end products. Despite the odds, many agencies have become involved in microinsurance.

---

A possible disadvantage could be that existing insurance products are too mechanically down-streamed to the poor, without proper specialised product development based on their needs and capacities. The firm may be inclined to sell more of what is already in place, rather than develop new products which may drive up costs. In such a set-up it would be the task of the MFI to take care that insurance becomes genuine microinsurance. If it fails to do so, it runs the risk of losing credibility.

Direct service delivery by insurance companies

An insurance firm can decide to move into microinsurance without using MFIs as agents and keep both product development and distribution under its own wings. This may reduce processing time and allow for strong controls throughout the system. But there are two potential disadvantages to overcome. First is the lack of a well-informed sparing partner presumably better informed about client needs and habits than the firm itself. This may negatively affect product design.
Microcare Ltd. was established in Uganda in 2000 to provide health insurance to low-income people. Initially it actively targeted clients from MFIs. To establish firm controls throughout the system, the company established its own check-in counters in medical facilities providing care to its clients. And to bring bureaucratic requirements for its clients back to a bare minimum, the company settles the bills for medical treatment directly with the care provider. While this system worked well to prevent fraudulent claims, co-operation with the MFIs was more difficult than expected. MFI staff had little experience with selling insurance products which led to inefficiencies in the system. Whilst continuing co-operation with MFIs, and working towards loan provision for premium payments, Microcare now also targets private sector companies with low-income employees and, on top of that, looks for acquisition opportunities to reach more clients. Performance is reportedly satisfying for an early stage system, the company established its own organisation.

The second is distribution. Particularly in rural areas with poorly developed communication and transportation it may be more cost-effective to rely on a distribution system that is in place already. In urban centres this potential disadvantage may not be so pressing. Moreover, rapid developments in the fields of information and processing technologies may open up rural areas quickly in the coming decade.

Lastly, there is the potential disadvantage of the ‘power balance’: the small client versus the big firm. Not a pretty perspective in case of dispute over a claim. One would be tempted to argue in favour of the MFI as go-between here, but that may carry the burden over to the MFI without it being able to actually mediate between client and firm: the catch 22 situation.

Self-help, mutual and co-operative models
A fourth frequently used model is the upgrade of old self-insurance systems. In the new set-up the group members either continue to insure themselves by setting up their own (health) insurance scheme, or bargain a collective deal with an existing company.

Advantages can be witnessed in the realm of self-control and self-management, which add to clients’ social capital base. Moreover, mutual systems do not have external shareholders but members. Any profit made will return to them, either as ‘dividend‘ or in the form of lower or zero premiums.

A disadvantage, in the first option of full self-insurance, is that risk leverage is very small which often implies a relatively slow process of growth and expansion. And as the membership remains small, transaction costs remain high as costs have to be spread over only so many policy holders.

Affiliated co-operatives
A somewhat hybrid model of co-operatives is the system where not individual clients act as members but where for instance a farmer co-operative or an NGO, or a chain of those, set up their own insurance co-op. They become the owners of the new insurance company, which is expected to service the members of the affiliated organisations.

This model has been in place for a long time and is quite popular in many developing countries. An educated guess has it that these affiliate insurance co-operatives to date have carried the bulk of the task of providing insurance products to lower-income groups. Rather than outsourcing its members’ insurance needs to a commercial firm, the NGOs and co-ops establish their own organisation. Potential advantages are obvious: the new firm is statutorily obliged to service the members of the affiliated organisations but can operate in a more flexible and responsive way, which is expected to attract more clients, rather than outsourcing its members’ insurance needs to a commercial firm, the NGOs and co-ops establish their own organisation. Potential advantages are obvious: the new firm is statutorily obliged to service the members of the affiliated organisations but can operate in a more flexible and responsive way, which is expected to attract more clients.

The second is distribution. Particularly in rural areas with poorly developed communication and transportation it may be more cost-effective to rely on a distribution system that is in place already. In urban centres this potential disadvantage may not be so pressing. Moreover, rapid developments in the fields of information and processing technologies may open up rural areas quickly in the coming decade.

Lastly, there is the potential disadvantage of the ‘power balance’: the small client versus the big firm. Not a pretty perspective in case of dispute over a claim. One would be tempted to argue in favour of the MFI as go-between here, but that may carry the burden over to the MFI without it being able to actually mediate between client and firm: the catch 22 situation.

Self-help, mutual and co-operative models
A fourth frequently used model is the upgrade of old self-insurance systems. In the new set-up the group members either continue to insure themselves by setting up their own (health) insurance scheme, or bargain a collective deal with an existing company.

Advantages can be witnessed in the realm of self-control and self-management, which add to clients’ social capital base. Moreover, mutual systems do not have external shareholders but members. Any profit made will return to them, either as ‘dividend‘ or in the form of lower or zero premiums.

A disadvantage, in the first option of full self-insurance, is that risk leverage is very small which often implies a relatively slow process of growth and expansion. And as the membership remains small, transaction costs remain high as costs have to be spread over only so many policy holders.

Affiliated co-operatives
A somewhat hybrid model of co-operatives is the system where not individual clients act as members but where for instance a farmer co-operative or an NGO, or a chain of those, set up their own insurance co-op. They become the owners of the new insurance company, which is expected to service the members of the affiliated organisations.

This model has been in place for a long time and is quite popular in many developing countries. An educated guess has it that these affiliate insurance co-operatives to date have carried the bulk of the task of providing insurance products to lower-income groups. Rather than outsourcing its members’ insurance needs to a commercial firm, the NGOs and co-ops establish their own organisation. Potential advantages are obvious: the new firm is statutorily obliged to service the members of the affiliated organisations but can operate in a more flexible and responsive way, which is expected to attract more clients.

The second is distribution. Particularly in rural areas with poorly developed communication and transportation it may be more cost-effective to rely on a distri-
In practice, however, these affiliate systems appear to be vulnerable to serious risks as well. The affiliates may be tempted to draw income from the insurance co-op to finance their development programmes; outreach pressure (affiliates may push the co-op to service all its own members or clients) may drive the insurance company to grow well beyond its handling capacity; affiliates may encourage their members to develop calculated behaviour; they may not perform their governance role responsibly, and so on.

Recently the CGAP Working Group on Microinsurance commissioned a study into worst practices in microinsurance and most of the cases studied involved such affiliate co-operatives. This brings us to the lessons learned.

In 1994 Columna was created by the Guatemalan National Federation of Credit Unions, which unites some 35 credit unions in the country, with a member base of half a million. All their members take Columna insurance products to protect their savings, contributions and credit balances, whereas some 10% take additional cover for funeral services and accidents. Both premium collection and claims handling is done through the 35 affiliates. Clients are reportedly satisfied with the services offered but are also demanding development of new products such as health insurance. In Peru a similar development took place with the establishment of Serviperú in 1994 by the Federation of Credit Unions out of a longer line of predecessors. And as in the case of Columna, what started with the protection of savings and credits, gradually evolved into a broader range of products, including health, property and life.

4. HOW NOT TO DO MICRO-INSURANCE

The CGAP commissioned study was compiled by the ICMIF, the International Co-operative and Mutual Insurance Federation. It contains nine examples of struggling larger insurance schemes and apart from offering a most interesting and revealing view of how, internally, things may go from bad to worse, it also offers very valuable lessons, named pitfalls and signposts.

A first potential cause of friction was identified at the level of mission and objectives. Not-for-profit insurance schemes may be over-enthusiastic, over-ambitious or simply unrealistic as to what they want and actually can achieve. Also the demand to service the financial interests of the constituting parties, the affiliates, may override the interests of the actual clients or the insurance firm takes up too many areas of insurance or too many clients at the same time, not allowing for a gradual development of expertise and a high quality policy book.

A second field of friction is about governance and management. These are common areas of concern in microinsurance as much as in microfinance. Responsibilities and expectations are high, profit margins and operational budgets are rather low, working and labour conditions may not be the best in the industry; is it a testing business indeed. But in microinsurance one particular phenomenon is especially troublesome at times: premium collection. In affiliated insurance structures premium collection often involves the affiliates themselves, opening the door to a range of ‘alternative arrangements’. That way, premium collection is frequently considerably behind schedule, or is only collected by way of deduction from a benefit payment. That puts the axe at the roots of financial prudence and most of the reported cases had faced problems in this respect.

A third major cause of friction is indeed about financial prudence. In many countries insurance regulators have strict rules about capital adequacy or solvency. As a rule of...
An insurance company needs to have a certain percentage of its overall risk exposure ready in the form of accessible capital, normally put together by equity and retained earnings. This varies from country to country, but often at least a third of the risk underwritten should be backed-up that way. The pressure to fiddle around with this rule can be great. Affiliates may not appreciate their earnings from profits being retained, there is the pull of bringing part of the capital to places where higher returns can be achieved, such as in stock markets, and there can be pressure to invest parts of the capital in new buildings or for financing of temporary operational losses. What affiliates moreover may have a problem with is putting up more capital to allow for growth of the operations. If adequacy levels have been pushed to their limits, the company can not write more policies, unless more capital is brought in. 

To a certain extent, the same pitfalls can be found in the microfinance industry, but this ICMIF document shows that the margins in microinsurance are smaller in comparison. One wrong strategic decision can put in motion an almost irreversible chain reaction of following disasters, with limited means available for remedial interventions.

From a developmental perspective the mutual insurance scheme easily appeals closest to a widely shared empathy for people-focused and empowering forms of insurance. It is as close as one can get to formalised self-insurance. Members are owners, allowing for people rather than shareholder focussed priorities in business operations, and it starts with mustering people’s own interests and resources for the well-being of the group or community at large.

Yet, the pitfalls are many and what may have gone well over a considerable period of time, can be brought down in no time by over-ambitious management, poor governance, self-interest from affiliate groups, backlogs in premium collection, ignoring government regulations or, fair and square, not heeding to the basic principles of insurance prudence for a wide range of other interests.

All the more reason to have a look at what the support industry can do promote and sustain the emerging microinsurance sector.
A. THE SETTING

Support for, or interest in microinsurance these days comes from a wide range of actors, not unlike the situation in microfinance. Microfinance institutions gearing up to become involved in insurance talk with funding agencies for some support in research and development, product design and running pilots. In some countries with a well-developed tradition of government involvement in the financial sector, governments simply set quota for their own banks and insurance companies to reach poor or remote clients. In such cases the companies approach MFIs to piggy-back on their distribution channels.

Then there is self-generated interest on the part of the commercial insurance sector. Growth targets and competition force them to be on the lookout for new markets and clients and if saturation points come in sight in established markets, they look further and deeper for new potential clients.

Special mention is justified for the established co-operative insurance sector. Apart from regular commercial interests to grow and deepen market penetration, domestically as well as internationally, they bring another prominent feature to the table in the form of corporate social responsibility. In the Northern hemisphere there is a great tradition of co-operative banking and insurance, and now that the poor are no longer considered unbankable and uninsurable, these companies realise that what they now see in developing countries is not totally dissimilar from the way they started themselves over a century ago. Hence a strong effort from these established co-operative insurers to transfer knowledge to counterparts in emerging economies.

Lastly, the funding community at large, from development finance institutions to private agencies, has come to subscribe to the United Nations’ Millennium Development Goals, and all keep their eyes open to contribute to reaching out to the billions of poor still un-serviced by financial intermediation. Microfinance has proven a point and micro-insurance is rapidly catching up.

And as much as in microfinance a fierce debate ran through the donor community on best donor or support practices, a similar debate has started on best practices in microinsurance. CGAP, a donor consortium group administered by the World Bank, has issued draft Preliminary Donor Guidelines for Supporting Microinsurance; ILO has produced a Technical Guide to Developing and Delivering Microinsurance (by MFIs); MicroSave, a CGAP, UNDP, and DFID sponsored R&D centre in Nairobi is doing field research; CGAP also launched a microinsurance newsletter and lastly there is the Micro Insurance Centre, a major resource hub managed by MicroSave, also issuing a news letter.

 Truly, then, there is no lack of donor interest and much of what all these initiatives produce makes good sense: it cautions against head-over-heels involvement, it identifies pitfalls in methodologies, it promotes demand side concerns and interests, and it takes stock of success stories, the so-called best practices.

Yet, it is not unfair to suggest that the major boost to grow the microinsurance sector has to come not from the donor community but from the insurance sector itself. That is where the technical capacity has been built up, that is also where the major leverage opportunities can be found. So after reviewing donor involvement, this paper will more closely look into ways and means the formal insurance sector can contribute to microinsurance.
B. DONOR INVOLVEMENT

In late 2003 CGAP issued so-called pre-
liminary donor guidelines for supporting micro-insurance, in 2004 followed by a neat
slide presentation under its Donor Direct
services. Both documents incorporate the
concerns following from MicroSave’s work.

It explains at some length the essentials of
microinsurance, the risks and opportunities
related to the sector and promotes a list of
do’s and don’ts for donor agencies willing
to become involved in supporting microin-
surance. It places emphasis on prerequisites
for donor involvement. The interested
donor is suggested to have three basic sets
of skills in the house before becoming in-
volved: knowledge to develop low income
markets, technical expertise in insurance,
and access to local market knowledge. If
not, the donor is advised to stay out and
perhaps consider supporting other risk
managing services such as savings systems.

But even with the skill sets in place, the
donor may not be ready to get started.
In any potential insurance market, it must
be established that potential clients are
genuinely interested in insurance products
and that the provision thereof indeed is the
most effective risk management solution. If
all that has been established, the prepara-
tions are still not completed. The donor still
has to look for an operator to support. If
there is one that meets a string of require-
ments, the donor is advised to proceed
cautiously; if not, the arrows in the interven-
tion process scheme rigorously point back
to square one: stay out. And being a donor
coordination body, it is no surprise that
CGAP recommends donors to co-ordinate	heir efforts with other donors.

At the more technical level of advice, the
recommendations make good sense as
well: encourage commercial insurers to
work with MFIs, don’t mess with govern-
ments and regulatory bodies, work with
strong institutions, and provide technical
assistance where needed and monitor
performance.

The above makes excellent sense for donor
agencies aspiring active or direct involve-
ment in microinsurance. In practice, however,
the demand for that is quite limited and can
not be compared to microfinance. The major
reason is that in insurance income and
capital has to come from the clients. It can
not come from outside the system beyond
the level of equity in commercial insurance
companies. Insurers under rules of regulation
are generally not allowed to borrow to pay
for claims, whereas microfinance institutions
can borrow to boost their loan portfolios.

Donor involvement for that reason is
mostly geared towards ‘soft funding’ such
as for technical assistance, referral services,
training, systems development and so on
and so forth. Typically a MFI approaches
a donor to get some support for market
surveys and the like if it intends to become
active in microinsurance. That, for donors,
is a fairly straightforward request to deal
with and it is debatable if they need the
mentioned skill sets in the house to arrive
at a knowledgeable decision. They will
simply assess if the requesting MFI is by
any chance capable of embarking on a
microinsurance course.

C. PRIVATE SECTOR
INVOLVEMENT

Private sector involvement in a way is a
different ballgame if it comes to supporting
microinsurance in developing countries.
Transfer of knowledge often is the entry
point. Assume that a donor wishes to
support a microfinance partner to explore
the option of microinsurance, it is likely to
link the requesting MFI to an established
insur-ance practitioner back home, also
assuming that the recommended skill sets
are not in the house at donor level as of yet.
The established company will work with the
MFI to see if all the essentials have been
thought trough and if systems are in place
or can be put in place. After the MFI
starts its first insurance programme, the
consulting company may still play an
advisory or monitoring role.
Partnership models are rapidly expanding. American giant AIG is partnering with 26 Ugandan MFIs, totally covering 12% of the population. Most partnerships, however, are in progress in India: Tata-AIG, ASA-Bajaj-Allianz, and Basix-Aviva for instance. Most of these partnerships start with life and loan coverage and some have proceeded into health and property insurance.

An interesting example of private sector involvement is the Micro Insurance Association Netherlands, MIAN. At the request of a donor agency, Rabobank Foundation, a major Dutch mutual, Interpolis, became involved in assisting two Foundation partners in Sri Lanka and the Philippines to establish a mutual in their own countries. This started a demand line for similar requests. Interpolis then established MIAN with various other mutuals in Holland in order to fulfil these requests. Professional staff of these companies are now actively supporting a range of emerging mutuals in Asia. And under the rules of corporate social responsibility, the companies allow their staff to do so in company time, so the client mutuals do not need to be charged for the assistance. Future plans of MIAN include the establishment of a training and knowledge centre for microinsurance where visitors can be exposed to the latest in the industry, as well as the introduction of a MA and PhD microinsurance programme with affiliated institutions of higher learning.

A different form of support is the direct involvement of local insurance organisations. They may see the MFI as the perfect marketing partner for their own products, or use the distribution capacity of the MFI to sell new products to a different clientele. This may lead to a classical agent position for the MFI, but also to elaborate joint ventures between insurance company and MFI.

At face value it would appear that microinsurance offers a perfect proposition for exploring public-private partnerships as there are three identified parties in the set-up. First, on the demand side there is growing interest from the poor to be serviced and a rapidly growing number of operators aims to catch of with that demand. Then there is a full-fledged international insurance sector that is willing and capable to assist these operators at low or no cost under their corporate responsibility policies. And there is a growing number of both donor agencies and governments to invest in the growth of the sector due to their MDG allegiance.

D. CHALLENGES
Pricing
Both microfinance and microinsurance need to be affordable in order to sustain the claim of providing low-cost financial services to low-income groups. However, it is questionable whether both sectors actually can make a justified claim to that end across the board.

In microfinance interest rates are high, sometimes outrageously high 50-100% per annum.20 From an opportunity cost perspective that may indeed be labelled affordable as the local money lender may be even more expensive. Yet, many in the microfinance sector, both practitioners and donor agencies, deep-down feel rather embarrassed when justifying that claim in learned papers explaining the legitimacy of these rates. Even more so when urging local politicians and governments not to question interest rate levels or propose interest caps or ceilings. In fact, such politicians are quite right formulating their question marks from a public interest perspective.

In microinsurance, a similar discussion is emerging. In the formal industry typical calculations follow this pattern: of all premium income 15-20% is set aside for the agent, 15-20% for operational costs, 5-10% for policy taxes, and a certain percentage for fraud, reinsurance premiums, profits and what is called friction: inefficiencies in the system. Common practice, then, indicates that approximately 45% of premium income is not used for paying claims, but to keep the system going. For poor people the question if they really can afford insurance is a serious one and many answer it in favour of continued complete reliance on savings and family support for their risk management.

In developed insurance markets clients make the same calculation but they arrive

14 Source: Regards, October 2004, carrying an article by Marc Nabeth of Planet Finance.

20 Not to mention some ‘developed microfinance markets’ such as South Africa where under the aegis of microfinance interest rates can easily be in the 100-200% range.
at a different conclusion. They know they pay a lot, if not too much, for their insurances but they can afford to and factor in other considerations such as peace of mind and longer term liquidity and asset protection. On top of that, many types of insurance in their countries may be mandatory, so clients simply stop calculating.

Whilst appreciating the validity of the cost calculation, the debate about affordability can not be decided by that argument alone.

Efficiency gains

If microinsurance is to succeed on a massive scale, costs have to come down considerably, plain and simple. That paves the way for greater affordability and, hence, social acceptance. And in practice many providers are experimenting with various, and often rather creative, ways to do so, mostly in the field of cost reduction at agent level.

A second line of major innovations may come from the rapid development of IT applications, significantly bringing down operational costs by reducing paper work to the bare minimum and outsourcing data processing to specialised firms. Simplification of products and procedures may further cut down operational costs.

Third, reinsurance and risk-sharing at global level may reduce risks and increase leverage allowing for substantial scaling-up, which will further reduce operational costs. But most of all, rethinking of established industry conventions may contribute to lower cost structures and higher levels of affordability.

Back to the roots

For that, it may be needed to go back to the roots of the mutual insurance system. These were set up by and for low-income groups and their interests were placed at the centre. The continuous drive to meet the needs of members, rather than clients, used to work very well as an incentive to thinking out of the box, exactly the mindset needed for stimulating creative solutions to complicated problems of risk management.

Takaful – Islamic insurance.

As in microfinance there is a growing demand for Islamic insurance as well. The basic fundamentals underlying the Takaful concept are very similar to co-operative and mutual principles, to the extent that the cooperative and mutual model is one that is accepted under Islamic law. These principles include the prohibition to derive advantage at the cost of others and the spreading of both losses and gains over the insured community. The European Council for Fatwa and Research declared it unlawful for European Muslims to take insurance products from commercial companies if there would be a good mutual or co-operative system in place. Some mutuals have special takaful windows for their clients, such as Bumiputra in Indonesia and Folksam in Sweden. Shiekan in Sudan is a full takaful insurance provider and the Takaful Nasional authority of Malaysia is preparing a micro-takaful scheme for the low-income sector in the country. Takaful Trinidad and Tobago is already pioneering this micro approach. 21

But as said before, insurance companies have a built-in tendency towards risk aversion and industry standards prefer consistency over creativity. In developed markets mutual insurance schemes are under some pressure these days. There is a trend to ‘corporatise’ or even ‘commercialise’ co-operatives to keep up with the genuinely commercial competition. Underlying this trend is a push to cash in on shareholder value, even if the assets to be sold off may have been accumulated over generations by hard-working members following a social appeal. Typically, these days mutuals do not compete with commercial insurance firms on issues such as social or human capital, but only on price levels and customer satisfaction.

Yet it is the social appeal that has driven mutuals to make the uninsurable insurable indeed in the past and it holds the promise of making microinsurance work not for a few but for many. That is why it would be good for the support sector to invest consider-ably in training, transfer of knowledge and product design to get microinsurance to a higher level, in terms of outreach as well as affordability.

21 Source: www.icmi.de/takaful.
Novib’s objective is ‘to promote a global society where the socio-economic inequalities between rich and poor are eradicated, where the world’s prosperity is distributed more justly and where people and sectors of the population can learn about and respect each other’s culture, while working together on their development on the basis of shared accountability and mutual solidarity’.

Novib is a member of Oxfam International, a growing group which currently consists of eleven organisations for development cooperation. Oxfam International supports more than 3000 counterparts in approximately 100 countries.

Oxfam International’s mission is ‘to generate global support for the conviction that poverty and exclusion are unjust, unnecessary and not sustainable’.

Oxfam International commits its moral, personal and financial resources to promote a worldwide movement towards economic and social justice in collaboration with citizens, businesses and governments. This commitment is echoed in the title of OI’s strategic policy plan for the next four years: ‘Towards Global Equity’.

Novib stands for an equitable world without poverty
www.novib.nl