

MICROINSURANCE

Improving risk management for the poor



June 2005

The Working Group on Microinsurance, initiated by CGAP and comprising of representatives from donors, multilateral agencies, NGOs, private insurance companies and other interested parties, was established in 2001 to promote the development of insurance services for the poor through increased stakeholder coordination and information sharing. Currently chaired by the International Labour Organization (ILO), the Working Group is organised into four subgroups: Operations and Donor Guidelines, Demand, Regulation and Dissemination. To share information about microinsurance initiatives, the Working Group issues this quarterly Newsletter. For more information contact Craig Churchill, churchill@ilo.org.

► Operations and Donor Guidelines subgroup: Tries to facilitate the emergence of appropriate insurance products for low-income persons, analysing current practices and improving donor practices in this field. Contact: mjmccord@bellsouth.net

► Demand subgroup: Seeks to develop tools that MFIs and other organisations can use to assess the demand for insurance and other risk-managing financial services. Contact: moniqueC@mfops.org

► Regulation subgroup: Will focus on regulatory issues that affect the development of microinsurance products for the poor. Contact: Svenja.Paulino@gtz.de

► Dissemination subgroup: Facilitate microinsurance information sharing among the industry, including MFIs, insurance companies, donors and experts. Contact: insurance@microfinance.lu

To receive the coming issues of MICROINSURANCE, please contact insurance@microfinance.lu

Concept

REINSURANCE AND MICROFINANCE

"Reinsurance plays an important role in reducing the fragility of small insurance schemes, and reinsurers can play a technical oversight role better than donors. Donors should use caution when supporting schemes that lack reinsurance".

This is one of the preliminary CGAP donor guidelines on microinsurance.

Apart from the fact that this statement does not take into account microinsurers who work with thousands or millions of clients, it has to be said that:

- On the one hand, the absence of reinsurance in microinsurance programmes has not hindered the development of the sector

- On the other hand, a badly gauged reinsurance contract can lead to huge disappointments. For example, a surplus share which offers a larger capacity than the quota share and which represents a good way to balance out the risk portfolio – in reducing the risk elements – is not relevant for microinsurance, because of the administration costs and the amount of administrative effort required.

Having said this, reinsurance is obviously an important element of microinsurance programmes and has three advantages:

- First, it reduces the risk of bankruptcy in bad years.

- Secondly, by freeing the microinsurer from the unexpected fluctuations of expenses, reinsurance removes the need for the microinsurer to build up reserves and allows him/her to use the earned surplus during good years.

- Thirdly, as highlighted by Jonathan Morduch in Micro-insurance: The Next Revolution?: "Unlike microfinance, say, it's not practical to start very small and slowly scale-up village by village; here, the local insurer must start fairly big if they are to entice an international reinsurer to be interested".

Many local microinsurers, aware of their exposure to risk and their limits in terms of capital and reserves, have therefore started to look for a true reinsurer. Most have been unsuccessful and, at best, have partnered with a formal insurance company which has taken over the role of reinsurer and, at worst, have set up a joint reinsurance scheme with other microinsurers. Alice Kengne Youmbi, president of ECLOF-Cameroon, has described this arrangement in the following terms: "All microinsurers which are members of a CNE network or a larger network reinsure each other".

The idea of such a reinsurance scheme amongst microinsurers does not seem appropriate. Reinsurance is a complex busi-

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ness and demands professionalism and experience. Setting up a network of microinsurers involves a risk of systemic bankruptcy, which would ruin the promotion of insurance in the concerned regions. Furthermore, such a system is very costly from a HR and administrative point of view.

The mistrust that private reinsurers show towards microinsurance is understandable considering the limited profit margins they can expect, compared to what the return would be in richer countries, and the lack of viable information which they could use to evaluate risks and price their services.

Is this a good enough reason? Undoubtedly, no, as proven by the growing implication of professional reinsurers on the microinsurance market: Interpolis Re, Swiss Re, Africa Re, Best Re, etc... The presence of

resinsurers is almost natural, as reinsurance remains a rich source of innovation and advice for insurers. The Long Term Care Insurance (LTC), which for long has been thought to be “not insurable” because it covered poorly known neurology pathologies, was after all originally invented by French reinsurers?...

The growing involvement of professional reinsurers

The growing involvement of reinsurance and professional reinsurers in microinsurance proves how mature the sector is. This involvement is valuable because

the functions of reinsurance – financing, capacity, stabilisation, protection against disasters, technical assistance, supervision and subscription advice, pricing and controlling moral hazard and adverse selection – are all necessary at a time when the growth of microinsurance translates itself in increased portfolio diversity.

It is nevertheless a mistake to perceive reinsurance as the solution to all problems. Jean- François Outreville, member of the American Risk and Insurance Association, qualifies the importance of reinsurance in developing countries, stating that reinsurance in itself does not lead to an increase in productivity and is not a means of pay-

ment, even if it does contribute positively to both, as is the case in microfinance programmes.

Reinsure the Planet?

This leads us to the attractive theory of Michel Vaté, which he presents in the bulletin of the Thomas More Institute. In the article “Reinsuring the planet – Towards a pro-poor financial globalisation”, Michel Vaté proposes, as a new financing tool for development, to establish a chain of reinsurance and a worldwide reserve fund fed by international public aid and private investors.

On a world economy scale (a single planet, a single mankind), the reinsurance chain's only limit is the capacity of the world market, which is now the smallest closed financial space. Let us examine the orders of magnitude: the most extreme known risks (natural or industrial catastrophes, 11th September terrorist attacks) are measured in tens of billions of dollars, the total capacity of insurers in hundreds of billions, daily capital movements in thousands of billions and total stock market capitalization in tens of thousands of billions. The daily volatility of this market can be measured by a standard deviation, which is measured in hundreds of billions of dollars. But a suitable mechanism is still necessary to connect local risks with the global financial sphere. There is already a World Bank. Why should there not be A World Re or Planet Ré, worldwide insurer? [...]

Planet Ré does not, therefore, have an ongoing action, but only reacts to events of a catastrophic nature. [...]

After the constitution of a starting fund, the necessary contributions could come from three sources of funding, as well as from the reinsurer's contributions:

- The first is international aid
- The second is private investors whose assets could be selected from the vast range of risk securitization tools (on the pattern of catastrophe bonds and weather derivatives);
- Finally [third], the level of reserve could be “mechanically” linked to the global volume of international transactions, which gives an indication of the ultimate capacity for reinsurance on a planetary scale. This could be done as by diverting to Planet Ré a tiny fraction of international capital movement. [...]

Source: Michel Vaté, *Reinsuring the planet – Towards a pro-poor financial globalisation*, Institute Thomas More, No. 15 January 2004

This idea is tempting, and the argument of an insurance counterpart to the World Bank (World Re or Planet Ré) seems timely and desirable. However, this vision of a worldwide financial reinsurance system which would go beyond an experimental or peer-review context, to us, is an utopia and could even hinder microinsurance, more than it would support it.

It is a utopia because establishing a subsidized reinsurance system would mean that one has identified at world level all the elements which block the development of a country. It would also mean that Planet Ré would possess control instruments able to deal with the diversity of local and community structures. In turn, this would entail establishing transparent mechanisms

which would not be abused by corrupt and non-democratic state authorities.

The Treaties of Reinsurance: a More Pragmatic Solution

The treaties of reinsurance proposed by experts seem more far reaching, as they are inscribed in field reality.

Working Excess of loss cover per risk (WXL/R) would seem to be the best solution for reinsuring life insurance policies. *Working Excess of loss cover per Event (WXL/E)* would suit Property microinsurance. Stop loss treaties¹ (works best with an accumulation of small disasters over a given period and would be perfect for health microinsurance, but would still be difficult to price and re-

quire a high level of professional expertise. With regards to weather risks, weather index contracts- (on the basis of climate data, using indicators like temperature, wind force, pluviometry, etc.) seems more relevant but remains quite restricted to experimental projects.

One can conclude that microinsurance definitely needs more partnerships, more flexibility and more follow-up from local and international actors, rather than a ready-made futuristic reinsurance system... however attractive such a system may appear to be.

Updated extract of Part III, Chapter 4 « La réassurance » of the MBA ENAss Thesis « Micro-Assurance : quand Rentabilité rime avec solidarité », 365 pages, Marc Nabeth, 2005. Contact: mnabeth.microinsurance@noos.fr

¹ A form of reinsurance that protects the ceding insurer against an aggregate amount of claims over a period, in excess of either a stated amount or a specified percentage of estimated benefit costs. An example of this type of cover is Employer Stop Loss (ESL) which is used by US companies to cap losses on self-funded group health benefit programmes. The stop-loss can apply to specific conditions or aggregate losses.

Concept

GENDER DIMENSIONS OF MICROINSURANCE:
QUESTIONING THE NEW BOOTSTRAPS

Microfinance has been promoted as a key strategy for poverty reduction. It is seen as the ideal self-help strategy whereby poor people can help themselves through productive use of loans and savings. Through their own efforts therefore they are seen to be able to pull themselves up out of poverty.

Microinsurance: The New Bootstraps

Since the end of the 1990s an increasing number of microfinance institutions have been trying to develop insurance products for their clients to reduce risk including: health and life insurance, livestock and crop insurance, property insurance, and compulsory insurance against loan defaults.

SEWA in India has pioneered provision of microinsurance to its members. BRAC's Grameen Kalyan (Welfare) has been implementing a health programme based on a combination of insurance premiums and co-payments made at the time of receiving treatment. Other examples include NHHP/FINCA Uganda, UMASIDA, SEWA and GRET. In some contexts indigenous mechanisms for informal insurance exist. For example in South Africa poor people combine resources from ROSCAs, other informal savings and credit arrangements and insurance to cover costly funeral expenses (Roth 2001).

However serious questions need to be asked about whose interests current approaches to microinsurance serve. Debates also have gender dimensions which had hitherto been ignored although women are often key target groups for microinsurance schemes.

Gender Specific Risks

Vulnerability to risk is a key aspect of poverty. Health problems, death of livestock and natural disasters all affect the poor disproportionately. Women also face specific types of risk because of gender discrimination:

- unequal control of property makes them extremely vulnerable in cases of divorce or widowhood.
- lower levels of income which makes them less able to invest in disease resistant strains of livestock, reliable equipment and/or to afford veterinary care.

- responsibility for caring for the sick which means that ill health of children and partners affects their own ability to earn income.
- higher levels of susceptibility to certain types of disease including HIV AIDS and also complications surrounding pregnancy and childbirth.
- physical vulnerability which makes their property particularly vulnerable to theft and crime.
- women's high preponderance in informal sector enterprises makes them particularly vulnerable to harassment by the authorities including confiscation property and destruction of market stalls.

Drop Out and Broader Issues

Many insurance programmes have experienced high levels of drop-out as people have been unable to keep up instalments in times of crisis (McCord 2001). Money paid for previous instalments and which could have been used for savings and production investment is therefore forfeited.

Again there are gender dimensions to these questions. For example:

- while it may be very important for women to be able to contribute to life and health insurance schemes for themselves and their husbands, insurance may not be the best solution where marriages are unstable. In this case women risk paying premiums, maybe out of their own consumption and investment funds, maybe to ensure loans which are used by men and then forfeit these premiums if they are unable to keep payments up following divorce and/or cannot claim on the death of ex-partners.
- women have high levels of illiteracy than men and lower levels of physical mobility in many cultures and may therefore be less able to understand policy conditions and follow-up claims unless these factors are taken into consideration. They may therefore be more recently deceived into taking up schemes which are not to their advantage and also less able to take advantage even of good insurance schemes without considerable follow-up by insurance providers.

- health problems which affect women for example pregnancy are often exempt from insurance policies.

Finally there are broader issues about the degree to which poor women and men should be required to take out insurance to decrease sources of vulnerability which should be met by public provision of health and welfare safety nets and/or employer-funded schemes:

- There are dangers that the availability of insurance may make private health practitioners increase charges and/or deny treatment to those without insurance. These issues are currently subject of considerable debate in Northern industrialised countries.
- There are also questions to be asked about whether people should be bearing the costs of risks like flooding, natural disasters and epidemics caused by failures by government and international agencies to address the underlying causes of climate change, environmental damage and spread of disease.
- The poorest and most disadvantaged are generally excluded from insurance provision. They will therefore be at serious risk if promotion of microinsurance is used as a pretext for decreasing public welfare provision, health and safety provision at work or donor funding in emergencies.

The whole thrust behind promotion of microfinance has been the search for a self-help strategy for poverty reduction which has limited costs for donors and avoids difficult questions about wealth redistribution and basic service provision. Microinsurance, like microfinance in general, is only useful as part of a broader programme to address the underlying causes of risk and vulnerability facing poor women and men.

This paper builds on work for a DFID-commissioned paper: Impact Assessment of Microfinance: Towards a Sustainable Learning Process which can be found on the Enterprise Development Impact Assessment Service (EDIAS) web site www.enterprise-impact.org.uk and represents the views of the author. It is a draft paper for further discussion. Comments and suggestions to the author Linda Mayoux are very welcome to L.Mayoux@dia1.pipex.com

Read the complete article at <http://www.oneworldaction.org/download/MicroFinPps/Microinsurance.doc>

Case Study

DELTA LIFE, BANGLADESH

Delta Life Insurance Company was founded in late 1986 soon after the denationalisation of the Bangladesh financial sectors. Delta Life's initial products consisted primarily of endowment policies, which combined contractual savings with life insurance, targeted at Bangladesh's middle and upper classes. In 1988, inspired by the growing success of the Grameen Bank and other microcredit schemes in Bangladesh, Delta launched an experiment of its own, Grameen Bima or village insurance. Initially, the design for Grameen Bima called for collaboration with a microcredit NGO that provided the delivery structure for Delta's endowment product. This partnership dissolved after a short time because of a difference in objectives.

Delta then developed its own delivery network and quickly realised the benefits of selling its own policies. Subsequently it developed and introduced an urban microinsurance project, Gono Bima, which offered a similar endowment product. In 1991, the company began introducing loans to complement the endowment policy. The loans were intended to stimulate additional income for policyholders, which would help to promote their economic development while making it easier for them to pay their premiums. This proved disastrous. Repayment fell to about fifty percent and Delta was left with a significant loan loss.

In the mid to late 1990s, Delta Life's microinsurance programmes experienced astonishing growth. Together, Grameen and Gono Bima grew from less than 40,000 new policies issued in 1994 to more than 450,000 policies issued in 1998. As the decade came to a close, however, Delta felt the effects of this reckless growth. The rapid

expansion revealed significant weaknesses in information systems, internal controls and administration.

Profits were also slow to come, or at least that was the impression. In 2002, Delta's board decided to spin off Gono and Grameen Bima into a non-profit company. However, after an actuarial report later that year showed that the microinsurance projects were actually contributing to profits, it was decided to retain the projects and reorganise them for greater efficiencies. A reengineering of the microinsurance operations in 2002 and 2003 included the following critical areas including MIS, product refinements, consolidating administrative functions, decentralising greater authority to the field, improving internal controls, and implementing more effective HR policies.

These adjustments have generated clear benefits to the company. Along the way, Delta Life has learned a number of valuable lessons, many of them the hard way. For example:

Institutional Lessons

- Delta has shown that it is possible for an insurance company to **create its own distribution network** to sell voluntary, individual insurance policies directly to the low-income market, and to achieve profitability, without any donor support, though over a rather long period.
- By building up its Ordinary Life (or traditional insurance) business to a fairly significant scale, **Delta cross-subsidised the start-up of the microinsurance activities**. For direct microinsurance to be possible, it probably needs to be offered by a com-

pany that also services the upper market so the organisation can create administrative efficiencies, professionalize systems, and lower expense ratios.

- Insurers have to **focus on their core competencies**. Although Delta's project loans were heralded as a tremendous accomplishment in the late 1990s, after a few years of reflection (and mounting bad debts), they are now seen as a major failure.
- **Microinsurance must be managed with the same business approach as traditional insurance**, even if the intention is to achieve developmental objectives. Good management is especially important for organisations that are entrusted with the longterm savings of poor households.
- Delta has not managed its tremendous growth very effectively. It recognises now that more **authority needs to be closer to the clients**.
- Microinsurers should not overlook **the critical importance of management information systems**, especially for large volumes of small policies. Effective management of an insurance business depends on timely and accurate information to: price products appropriately, pay claims expeditiously, manage staff effectively, monitor performance carefully, etc.
- **When money is involved, fraud will not be too far behind**. Careful attention should be given to internal controls before an organisation pursues exponential growth.

CGAP Working Group on Microinsurance Good and Bad Practices Case Study No. 7: Delta Life, Bangladesh. Michael J. McCord and Craig Churchill (February 2005). Source: http://www.microfinancegateway.com/files/25381_file_Delta.pdf

More Info

Terms and Definitions

Reinsurance: A form of insurance that insurance companies buy for their own protection. One or more insurance companies assume all or part of a risk undertaken by another insurance company.

Source: Microinsurance Center Glossary at <http://www.microinsurancecenter.org/index.cfm?fuseaction=glossary.r>

Reinsurance means that one insurer agrees, for a charge (the premium), to reimburse another insurer against all or part of a loss. The terms of the insurance coverage (the types of losses covered and the method for determining the amount to be reimbursed) are laid out in the reinsurance agreement, also known as the policy or policies of insurance. The company purchasing reinsurance is known as the ceding insurer, or, more simply, the reinsured; the company selling reinsurance is known as the assuming insurer, or, more simply, the reinsurer. Described as “insurance of insurance companies”, reinsurance serves to spread the risk so that no single entity finds itself faced with a financial burden beyond its ability to pay.

Source: Microfinancegateway Highlight on Reinsurance at http://www.microfinancegateway.org/microinsurance/highlight_re.htm

Selected Info

About an insurance product

INDIA'S MICRO HEALTH INSURANCE UNITS: FOCUSING ON EVIDENCE, POLICY RECOMMENDATIONS AND CAPACITY BUILDING

The project Strengthening Micro Health Insurance Units for the Poor in India is conducting a household survey in seven locations in India, which will reach more than 4,500 households. The purpose is to gather evidence on the activities of micro health insurance, and on needs of the clients in India. Other related research activities include key informant interviews, focus group discussions and testing of a software application for administration, accounting and claims processing. “Please note that this is not a research project; everything we do aims to improve the operation of micro health schemes cooperating with us, develop administrative capacity and formulate policy recommendations for a more favourable regulatory environment” says Prof. David Dror, lead expert of the project. The project set itself the objective to identify features and practices that improve the efficiency and equity of micro health insurance schemes, at the four stages of the business process: product design and pricing, sales and distribution (including trust-building among clients), product servicing (claims processing) and the long term financial stability of the schemes.

The immediate deliverables of this project will be: (i) Engaging students from India and Europe, at the Masters' level, in cross-cultural teaching/training/research focusing on micro health schemes in India; (2) formulating a set of policy recommendations for politicians and regulatory authorities, as well as (3) formulating recommendations for microinsurance managers on administrative-managerial issues relating to their scheme; and (4) preparing the business case for the establishment of an institution missing in the Indian microinsurance scenario: A reinsurance for community based schemes. This reinsurance facility would assist micro insurers in two ways: It should back up their financial stability through reinsurance operations and offer underwriting assistance and other technical support.

The project is implemented jointly by the Institute for Health Policy and Management at the Erasmus University Rotterdam, the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Department of Cooperative Studies of the University of Cologne. Financial support is granted by the European Commission within the EU-India Economic Cross Cultural Programme (ECCP).

More information: www.microhealthinsurance-india.org

Events

Munich Re has launched the **Munich Re Foundation** in April 2005. The foundation's main objective is to find solutions and converting knowledge into action, as to provide support for people in risk situations. One of its many activities will be the organisation of a **micro-insurance expert meeting in October 2005**. In cooperation with the CGAP Working Group on Microinsurance, around a hundred selected experts from international organisations, NGOs, development-aid organisations and the insurance industry will be dealing with the experiences and challenges of microinsurance. More information: <http://www.munichre-foundation.org/StiftungsWebsite/TopicsAndProjects/Poverty/WorkshopMicroinsurance/>

INAFI-LA held a workshop on **Identifying New Microfinance Products** from **June 15-16, 2005** in La Paz, **Bolivia**. It focused on remittances, microleasing and microinsurance. Contact: inafi@inafi-la.org

The **French Federation of Insurance Companies** and the **Thomas Moore Institute** organised a study day on **Insurance, Reinsurance: Another Contribution to Development** on June 14, 2005 in Paris. More information: <http://www.institut-thomas-more.org/showNews/38>

Latest Publications

Insurance Products Provided by Insurance Companies to the Disadvantaged Groups in India (ILO/STEP, 2005). This working paper reviews 83 insurance products through a user-friendly presentation which classifies the information gathered on 27 public and private insurance companies. Download at <http://www.ilo.org/public/english/protection/socsec/step/download/823p1.pdf>

Inventory of Micro-Insurance Schemes in the Philippines (ILO/STEP, 2005). The Inventory aims at identifying the main community-based micro-insurance schemes currently operating in the Philippines. Download at <http://www.ilo.org/public/english/protection/socsec/step/download/827p1.pdf>

Surviving Disasters and Supporting Recovery: A Guidebook for Microfinance Institutions (Eileen Miamidian, Margaret Arnold, Kiendel Burritt and Marc Jacquand, Disaster Risk Management Working Paper Series, World Bank/UNCDF, No. 10). This report outlines practical steps on how MFIs should prepare for natural disasters. Download at <http://www.worldbank.org/hazards/files/disasterguidefinal.pdf>

A Regulatory Review of Formal and Informal Funeral Insurance Markets in South Africa (Hennie Bester, Doubell Chamberlain, Ryan Short and Richard Walker, Finmark Trust, by Genesis Analytics, April 2005). This market review includes a very comprehensive overview of how the funeral insurance industry operates. Download at <http://www.finmark.org.za/documents/2005/MAY/RegReviewInsurance.pdf>

CGAP Working Group on Microinsurance Good and Bad Practices Case Study No. 8: MUSCCO: Malawi Union of Savings and Credit Cooperatives (Sven Enarsson and Kjell Wirén, March 2005). This paper details the growth of MUSCO and lists the lessons learnt from its experience. Download at http://www.microfinancegateway.com/files/24123_file_MUSCCO_Good_and_Bad_Case_Study_8.pdf

CGAP Working Group on Microinsurance Good and Bad Practices Case Study No. 9: AIG Uganda (Michael J. McCord, Felipe Botero, and Janet S. McCord, April 2005). Eight years after AIG Uganda became involved in microinsurance, this case study examines what AIG has learned in developing and providing an insurance product for an MFI's clients. Download at http://www.microfinancegateway.com/files/25380_file_AIG_Good_and_Bad_Practices_No_9.pdf

Livestock Insurance: Vital, High-Tech, and Growing (Erich Kasten, ICMIF World Issue 52, Q2, 2005, p. 6f). This article provides an overview of the livestock sector, and the new technologies and opportunities available for insurers. Also available in French. Contact: icmif@icmif.org

News from the Working Group

Operations Subgroup

Case Studies: So far nine case studies have been published and another nine are in process, including SEWA in India, La Equidad in Colombia and ASSEF in Benin. This second set of nine will be published during the course of the summer, including several that look critically at the partner-agent model. In addition, another six case studies are under contract -- most of which focus on health insurance. We should expect first drafts of those cases by the end of August.

Good and Bad Practices Book: The findings from the case studies will be analysed and synthesised by a host experts, including Working Group members as well as actuaries, academics and other practitioners. Many of the chapters' authors will present initial findings at the Munich Re conference in October, and then will make adjustments based on the feedback from the conference participants. The book will be published in 2006 with financial assistance from Munich Re, Sida and the ILO.

The case studies are available on

<http://www.microfinancegateway.com/section/resourcecenters/microinsurance/?PHPSESSID=bd7c3e06c381b1ff6ee8e24524f099d8>