I Principles and practices

1.1 What is insurance for the poor?

Craig Churchill

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1 Defining microinsurance

Low-income persons live in risky environments, vulnerable to numerous perils, including illness, accidental death and disability, loss of property due to theft or fire, agricultural losses, and disasters of both the natural and man-made varieties. The poor are more vulnerable to many of these risks than the rest of the population, and they are the least able to cope when a crisis does occur.

Poverty and vulnerability reinforce each other in an escalating downward spiral. Not only does exposure to these risks result in substantial financial losses, but vulnerable households also suffer from the ongoing uncertainty about whether and when a loss might occur. Because of this perpetual apprehension, the poor are less likely to take advantage of income-generating opportunities that might reduce poverty.

Although poor households often have informal means to manage risks, informal coping strategies generally provide insufficient protection. Many risk-management strategies, such as spreading financial and human resources across several income-generating activities, result in low returns. Informal strategies for coping with risk tend to cover only a small portion of the loss, so the poor have to patch together support from a variety of sources. Even then, informal risk protection does not stand up well against a series of perils, which unfortunately is a situation often experienced by the poor. Before the household has a chance to fully recover from one crisis, they are struck by another.

Microinsurance is the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. This definition is essentially the same as one might use for regular insurance except for the clearly prescribed target market: low-income people. However, as is demonstrated in this chapter and throughout this book, those three words make a big difference.

How poor do people have to be for their insurance protection to be considered micro? The answer varies by country, but generally microinsurance is for persons ignored by mainstream commercial and social insurance schemes, persons who have not had access to appropriate products. Of particular interest is the provision of cover to persons working in the informal economy who do not have access to commercial insurance nor social protection benefits provided by employers directly, or by the government through employers. Since it is easier to offer insurance to persons with a predictable income, even if it is a small sum, than to cover informal economy workers with irregular cash flows, the latter represent the microinsurance frontier.

Microinsurance does not refer to the size of the risk carrier, although some microinsurance providers are small and even informal. There are, however, examples of very large companies that offer microinsurance, such AIG Uganda, Delta Life in Bangladesh and all insurance companies in India.[1] These large insurance providers have a product or product line that is appropriate for low-income persons.

An important aspect of microinsurance, explored in detail in Part 4, is that it can be delivered through a variety of different channels, including small community-based schemes, credit unions and other types of microfinance institutions, as well as enormous multinational insurance companies. In fact, Allianz, one of the largest insurance companies in the world, has recently launched an initiative with the United Nations Development Programme (UNDP) and the Gesellschaft für Technische Zusammenarbeit (GTZ) to provide insurance to the poor in India and Indonesia.

Microinsurance also does not refer to the scope of the risk as perceived by the clients. The risks themselves are by no means "micro" to the households that experience them. Microinsurance could cover a variety of different risks, including illness, death and property loss – basically any risk that is insurable.[2] This book, however, focuses primarily on life and health insurance as demand research across many countries repeatedly identifies illness and death risks as the primary concern of most low-income households *(see Chapter 1.2)*.

Often people use the term insurance loosely to refer to general risk-prevention and -management techniques. For example, savings set aside for emergency purposes might be referred to as an insurance fund. This book, however, uses a narrower definition in which microinsurance, like traditional

[1] As described in Chapter 5.2, Indian insurance companies are required to allocate a percentage of their insurance portfolio to persons in the "rural and social sectors", which in practice means low-income households. Consequently, all Indian insurers are involved in microinsurance in one way or another, so many interesting microinsurance innovations are coming from India.

[2] Chapters 1.2 and 2.1 describe the characteristics of insurable risks.

insurance, involves a risk-pooling element. Those in the risk pool who do not suffer a loss during a particular period essentially pay for the losses experienced by others. Insurance reduces vulnerability as households replace the uncertain prospect of losses with the certainty of making small, regular premium payments. Yet this risk-pooling function means that insurance is a much more complicated financial service than savings or credit.

Since microinsurance is just one of several risk-management tools available to low-income households, organizations truly concerned about helping the poor to manage risks should assess whether the provision of microinsurance is the most appropriate response. For risks that result in small losses, for risks with high predictability of occurring or high frequency of occurrence, savings and emergency loans would be more appropriate risk-managing financial services. Savings and credit are also more flexible than insurance as they can be used for a variety of different risks (and opportunities). Insurance, on the other hand, provides more complete coverage for large losses than poor households could provide on their own. For these larger risks, participating in a risk pool is a more efficient means of accessing protection than if households try to protect themselves independently.

One must be careful not to overstate the developmental effect of insurance. On its own, insurance cannot eliminate poverty. Yet if it is available to poor women and men along with other risk-management tools, health and life insurance for the poor can make a valuable contribution to achieving the Millennium Development Goals *(see Box 1)*.

Box 1

Microinsurance and the MDGs

The Millennium Development Goals, established by the United Nations in 2000, provide more than 40 quantifiable indicators to assess the progress made toward global economic and social development by 2015. The MDGs serve as a development framework, helping to focus the attention of policymakers, donors and development practitioners on the most critical objectives.

Certain MDGs would be more achievable if insurance were widely available among low-income households, including the following targets:

– Halve the proportion of people whose income is less than one dollar per day
– Halve the proportion of people who suffer from hunger
– Ensure that children everywhere, boys and girls alike, will be able to complete a full course of primary schooling
– Eliminate gender disparity in primary and secondary education
– Reduce by two-thirds the under-five mortality rate

– Reduce by three-quarters the maternal mortality ratio
– Halt and begin to reverse the spread of HIV/AIDS
– Halt and begin to reverse the incidence of malaria and other major diseases

For example, insurance can help reduce the proportion of people who suffer from hunger and whose income is less than one dollar per day. While development experts tend to focus on efforts to promote economic development as a strategy to achieve these targets, they have to recognize that gains can quickly be lost when vulnerable households experience a loss or crisis. It is necessary to complement efforts to boost productivity with corresponding efforts to provide protection.

Perhaps even more directly, microinsurance can help address the health-related objectives of reducing child mortality, improving maternal health and combating HIV/AIDS, malaria and other diseases. Health microinsurance schemes typically provide immunizations, train birth attendants and make it possible for women to afford transportation and hospitalization for difficult births.

Some microinsurance schemes provide valuable information and resources for risk prevention. By providing education about risks and promoting good health habits, these schemes can reduce incidents of disease and extend life expectancy *(see Chapter 3.9)*.

Interestingly, microinsurance can also assist in promoting gender equality and empowering women *(see Chapter 2.4)*. If insurance can help protect vulnerable households from falling back or further into poverty, they will be less likely to have to choose which child to send to school. Furthermore, long-term savings and insurance policies enable the poor to accumulate assets that can be used to pay for education, for daughters as well as for sons.

2 The two faces of microinsurance

There are two main varieties of microinsurance – one focused on extending social protection to the poor in the absence of appropriate government schemes and the other offering a vital financial service to low-income households by developing an appropriate business model that enables the poor to be a profitable (or sustainable) market segment for commercial or cooperative insurers.

Yet these two varieties have much in common. One might consider microinsurance like Janus, the ancient Roman god of gates and doors, also the god of beginnings, who is depicted with two faces, yet one body *(Figure 1)*. Regardless of whether one is looking at microinsurance from a social-protection or a market-based approach, the body of the insurance scheme, its

basic operations, will be largely the same. Hence a book on microinsurance operations must draw lessons and experiences from both.

Figure 1 **Janus: The two faces of microinsurance**

2.1 Deepening access to insurance services: A new market

The guru behind the articulation of the "new market" perspective is C.K. Prahalad (2005), who illustrates in his book *The fortune at the bottom of the pyramid* that the "private sector, in its desire to … gain market coverage, will invent new systems depending on the nature of the market". Prahalad identifies the more than four billion persons living on less than US$2 per day as a market opportunity if the providers of products and services, including multinational corporations, innovate new business models and create low-income consumers.

This thinking is certainly not new to those involved in microfinance, where commercialization has been underway since 1992 when the Bolivian microfinance NGO Prodem created BancoSol, the first commercial bank dedicated to serving the low-income market. The creation of BancoSol started a revolution that has inspired at least 39 other NGOs to create regulated financial institutions (Fernando, 2004) and numerous commercial banks and finance companies to reach "down market".

Besides microfinance, Prahalad also draws examples from other industries, including construction, consumer goods and healthcare. Based on case studies of successful innovations, Prahalad identifies common principles to be considered when innovating for the bottom of the pyramid (BOP). Even though he does not analyse insurance case studies, Prahalad's "Twelve Principles of Innovation for BOP Markets" are remarkably applicable to the provision of microinsurance *(see Box 2)*.

Box 2

Applying Prahalad's "Twelve Principles of Innovation for BOP Markets" to microinsurance

1. New understanding of price-performance relationship
Obviously, the poor cannot afford to pay high prices, but that does not mean that they deserve poor-quality products. For microinsurance, it could even be argued that the low-income market requires a *better*-quality product (e.g. quick claims settlements, few if any claims rejections) to overcome their apprehension about paying up-front for some undetermined future benefit. Prahalad also contends that the BOP market is surprisingly brand-conscious, something that microinsurers must keep in mind as they strive to secure the market's trust and confidence.

2. Combine advanced technologies with existing infrastructure
Although this is just beginning to emerge in microinsurance, several microfinance institutions are experimenting with technologies, (including ATMs with biometrics, smartcards, palm pilots and point-of-sale devices) to enhance efficiency and productivity. Microinsurers will undoubtedly follow suit.

3. Scale of operation
In a BOP business model, the basis for returns on investment is volume. Even if the per unit profit is minuscule, when it is multiplied across a huge number of sales, the return can become attractive to shareholders. This attribute is a perfect fit for insurance and the Law of Large Numbers, whereby actual claims experience should run much closer to the projected claims when the risk pool is larger. When projections can be estimated with a high degree of confidence, then the product pricing does not have to include a large margin for error, making it more affordable for the poor.

4. Eco-friendly
Prahalad notes that the resources associated with products in developed countries would be unsustainable if used for the enormous BOP market. Consequently, all innovations must minimize packaging and consider the impact of the product on the environment. This principle may not be directly applicable to microinsurance, however there is a connection. Many catastrophic risks to which the poor are vulnerable are associated with climate change.

5. Requires different functionality
Products and services for the BOP market cannot just be scaled down or less expensive versions of traditional products. With microinsurance, for example, insights into how low-income households might use an insurance payout illustrate key differences with the conventional insurance market. For example, instead of a lump sum of cash, the poor might prefer in-kind benefits (e.g., funeral service, groceries) possibly spread over a period of time.

6. Process innovation
When designing a product for the BOP market, it is necessary to adapt the process as well as the product, taking into account the limited infrastructure typically available for the poor. In microinsurance, for example, one must recognize that the premium is not the only expense. The indirect costs of accessing and using that product, including transportation and the opportunity costs of lost wages, may be much higher than the actual cost.

7. Deskilling work
Service industries are naturally labour-intensive; those focusing on the BOP market are even more so, given the scale of operations. Since labour costs can represent over half of the total operating expenses, one strategy to contain costs is to simplify the operations so that products can be sold and serviced by less expensive workers. Such an approach is quite appropriate for microinsurance because the customers also want simple, easy-to-understand products.

8. Significant investments in educating customers
Prahalad is explicit about the importance of creating BOP consumers through education and the raising of awareness, using innovative mechanisms to reach persons in "media dark zones". This has also been the experience of microinsurers which need to explain to their clients how insurance works and how they will benefit from it.

9. Designed for hostile conditions
The products and services designed for the BOP market must take into consideration the unsanitary conditions and limited infrastructure (e.g. electricity blackouts, poor water quality). For microinsurance providers, this involves investing in loss-prevention measures such as promoting low-risk behaviour, water purification and hygiene in order to reduce claims for health and life insurance.

10. User-friendly interfaces
The heterogeneous BOP market speaks a myriad of languages with a variety of different literacy levels. Serving this market requires careful consideration to make it easy for poor households to use the service. For microinsurance, the application form should be short and perhaps completed by the sales person. More challenging is the simplification of claims documentation to make it easy for clients to access benefits while protecting insurers from fraud.

11. Distribution
One of the great challenges in serving BOP consumers is to get the product to the market; yet, insurance companies are particularly weak at distribution. The main solution to this problem is to collaborate with another organization that already has financial transactions with low-income households so the insurer can leverage existing infrastructure to reach the poor.

12. Challenge the conventional wisdom
In sum, to serve the low-income market, insurers have to think differently – about customers' needs, product design, delivery systems and even business models. There is a viable market out there if insurers are willing to learn about that market and develop new paradigms for serving it.

To understand clearly how to develop new business models for microinsurance, it is necessary to assess why the current insurance business models do not reach the poor. Although the insurance industry is beginning to notice the vast under-served market of low-income households, insurers have encountered numerous obstacles that need to be overcome if they are to offer microinsurance on a large scale.

Besides the problems associated with high transaction costs and inappropriate distribution systems identified in Box 2, the products generally available from insurers are not designed to meet the specific characteristics of the low-income market, particularly the irregular cash flows of households with breadwinners in the informal economy. Other key product design issues include appropriate insured amounts, complex exclusions and indecipherable legal policy language, all of which conspire against effectively serving the poor.

It is generally assumed that low-income men and women are more vulnerable to risks than the not-so-poor; however, insurers generally do not have data to interpret the vulnerabilities of the poor. To address such a problem, insurers may build in a hefty margin for error and then make adjustments once the claims experience starts rolling in. However, if insurers build

in a cushion on top of the high administrative costs required to serve the low-income market, premiums may not be affordable.

Insurers assume, rightly or wrongly, that the low-income market cannot afford insurance. Interestingly, when insurance first became widespread in the late 19th century, it was seen as a poor man's financial service. The wealthy did not need insurance because they could essentially self-insure. Somewhere along the way, as insurance became more sophisticated and the wealthy recognized their vulnerabilities, the perceptions reversed.

Insurers do not have the right mechanisms to control certain insurance risks, such as adverse selection and fraud, among the low-income market. For example, the claims documentation methods and verification techniques used to ensure that someone with a US$100,000 life policy is not defrauding the insurer are inappropriate for a US$500 policy.

A major challenge in extending insurance to the poor is educating the market and overcoming its bias against insurance. Many are sceptical about paying premiums for an intangible product with future benefits that may never be claimed – and they are often not too trusting of insurance companies. Creating awareness about the value of insurance is time-consuming and costly. To be fair, the bias goes in both directions. The people who work for insurance companies are usually unfamiliar with the needs and concerns of the poor. Similarly, the culture and incentives in insurance companies reward salespersons for focusing on larger policies and more profitable clients and portray the idea of selling insurance to the poor as ridiculous.

This low-income market has massive potential if insurers can address these issues with efficient and effective innovations. While these obstacles are significant and daunting, they can be overcome – they are being overcome – by a number of formal and informal insurers around the world that are developing new techniques to reach a vast under-served market.

2.2 Providing social protection for informal workers

Even with significant innovations to insurance business models, product designs and delivery channels, it is clear that not everything or everyone is insurable based on market principles. Nor should that be the case. Indeed, governments have a critical responsibility to provide social protection to their citizens.

Social protection is the other face of microinsurance. It generally includes a variety of government policies and programmes to reduce poverty and vulnerability by diminishing people's exposure to risks and enhancing their capacity to protect themselves. Social protection refers to the benefits that society provides for its members, including:

- unemployment and disability benefits,
- universal healthcare,
- maternity benefits,
- old-age pensions,
- protection for children and the disabled.

However, more than half the world's population is excluded from any type of social security protection, including contribution-based schemes and tax-financed social benefits. In some parts of the world, the situation is particularly severe. In sub-Saharan Africa and South Asia, the coverage of statutory social security is estimated at 5 to 10 per cent of the working population (ILO, 2001).

Developing countries face major challenges in connection with providing comprehensive social protection. The vast majority of persons work in the informal economy, so there are no effective mechanisms to reach them systematically. Since they are self-employed or working in informal businesses, there is no formal employer to make contributions to pension, unemployment or healthcare schemes. Yet, the working poor cannot afford the full cost of social security schemes. At the same time, governments in many developing countries do not have the resources to create sufficient infrastructure (e.g. healthcare facilities) nor pay for the recurring expenses associated with social protection schemes.

Microinsurance as a social protection mechanism strives to fill the gap to provide some coverage for the excluded – which would be even more effective if it were supplemented by government schemes to facilitate a redistributive effect. In the absence of formal social protection, microinsurance responds to an urgent need while not absolving governments of their responsibilities. Indeed, as described in Chapter 1.3, microinsurance can create delivery mechanisms to extend government programmes (and subsidies) to the informal economy, and in so doing integrates the informal and formal social protection systems.

Consequently, regardless of which face of Janus one uses to view microinsurance, the intention is to reduce the vulnerability of the working poor by enticing the public (social protection) and the private sector (new market), or both, to do what neither has so far been particularly effective in doing: providing insurance to the poor. Indeed, since these two faces have the same head, it is reasonable to explore areas of convergence to create alternative models or systems of protecting the poor, such as public-private partnerships, mutuals and cooperatives, and government incentives to correct market failures.

3

What a difference three words make

The operational aspects of extending insurance to low-income households are largely the same, whether one is approaching it from a market or social-protection perspective. The following key characteristics illustrate how insurance for the poor may differ from both conventional insurance and mainstream social-protection programmes:

Relevant to the risks of low-income households
Of course coverage should be linked to the greatest areas of vulnerability for low-income households, but often what is available from insurers or social security administrations does not really address the needs of the poor. Can unemployment insurance really be made relevant for casual day labourers? Do commercial insurers really know what risks poor men and women are most concerned about, what keeps them awake at night?

As inclusive as possible
While insurance companies tend to exclude high-risk persons, microinsurance schemes generally strive to be inclusive. Such an approach makes sense when microinsurance is seen as an extension of government social protection schemes. Indeed, to achieve the social mission of microinsurance, it is necessary to provide protection when vulnerable households need it the most. However, is inclusion feasible for market-based microinsurance? Since the sums insured are small, the costs of identifying high-risk persons, such as those with pre-existing illnesses, may be higher than the benefits of excluding them in the first place. Plus, if microinsurance schemes can reach the tremendous volumes of customers required to achieve the MDG targets, many exclusions and restrictions can be just administrative nuisances that undermine efficiency rather than important insurance risk control tools.

Affordable premiums
At the end of the day, microinsurance schemes have to be affordable for the poor, otherwise they will not enrol in the scheme, nor benefit from the coverage. Various strategies could make microinsurance affordable, including having small benefit packages, spreading premium payments over time to correspond with the household's cash flow and supplementing premiums with subsidies from governments. From the social protection perspective, the redistribution function, from rich to poor, theoretically helps to make contributions affordable for the poorest. In the market model, insurers may be willing to accept low short-term returns, or even losses, to develop the market.

Grouping for efficiencies

Group insurance is more affordable than individual coverage, but how does one find groups of people in the informal economy? Even though the informal economy is sometimes known as the disorganized sector, there are groupings out there that could be used, such as women's associations, informal savings groups, cooperatives, small business associations and the like. Some microinsurers use these groups more effectively than conventional insurers by enlisting the support of the groups in member selection and reducing insurance risks such as over-use and moral hazard.

Clearly defined and simple rules and restrictions

A CEO of a major United States insurance company once admitted that even he did not understand his homeowner's insurance policy. Insurance contracts are generally full of complex conditions, conditional benefits, written in legalese that even lawyers struggle to discern. Although the rationale for the fine print may be consumer protection, if the consumers do not understand what is written, its very object is defeated. Moreover, its content can give the insurance company an excuse not to pay a claim. For a host of reasons, microinsurance has to be kept as simple and straightforward as possible so that everyone has a common understanding of what is and is not covered.

Easily accessible claims documentation requirements

The process for accessing benefits, from social security departments or insurance companies, tends to be so arduous that it discourages all but the most persistent claimants. Such obstacles are inappropriate for low-income households that cannot afford to spend days away from work, paying "unofficial fees" to access official documents. While controls have to be in place to avoid fraudulent claims, for microinsurance to be effective, it has to be easy for low-income households to submit legitimate claims.

Strategies to overcome the wariness of customers

Lastly, microinsurers must have effective strategies to overcome the apprehension of low-income households as regards insurance. One of the primary ways to achieve that objective is through client education, to raise awareness among prospective policyholders about how insurance works and how it can benefit them. Equally important, however, is upholding promises and fulfilling obligations, and creating a culture of insurance among the poor. For microinsurance to build the confidence of the market, it has to avoid many of the common criticisms of insurance providers, who are seen as quick to take one's money, but slow to pay it out. Indeed, microinsurance needs to develop

systems to pay benefits expeditiously, to minimize or avoid claims rejections and to provide a quality of service that earns the trust of a wary market.

For both the social protection and market perspectives, insurance schemes for the poor have to find a way of balancing three competing objectives: 1) providing **coverage** to meet the needs of the target population, 2) minimizing operating **costs** for the insurer and 3) minimizing the **price** (including the transaction costs for the clients) to enhance affordability and accessibility. These represent difficult choices that are best answered by involving those who ultimately benefit from the coverage to choose between them.

In summary, microinsurance must be designed to help poor people manage risks. With that overarching objective forging a unique mindset, microinsurance clearly emerges as quite distinct from mainstream insurance and social protection schemes. Perhaps when they first emerged, both social and commercial insurance were also founded on the ideal of protecting the poor. For example, some of today's large insurance companies began in the 1800s as mutual protection schemes among factory workers. Nevertheless, over the years, efforts to prevent fraud and misuse have created a maze of bureaucratic rules and requirements that undermine their effectiveness and their appropriateness for the poor. In addition, for the market-based approach, efforts to maximize shareholder returns have led them away from their original clientele in search of more profitable customers.

Indeed, microinsurance can be described as an insurance "back to basics" campaign, to focus on the risk-management needs of vulnerable people, and to help them manage those risks through the solidarity of risk pooling. Although not all microinsurance schemes are true to these values, the closer they can come, the more likely they will benefit the people who need them the most.

1.2 The demand for microinsurance

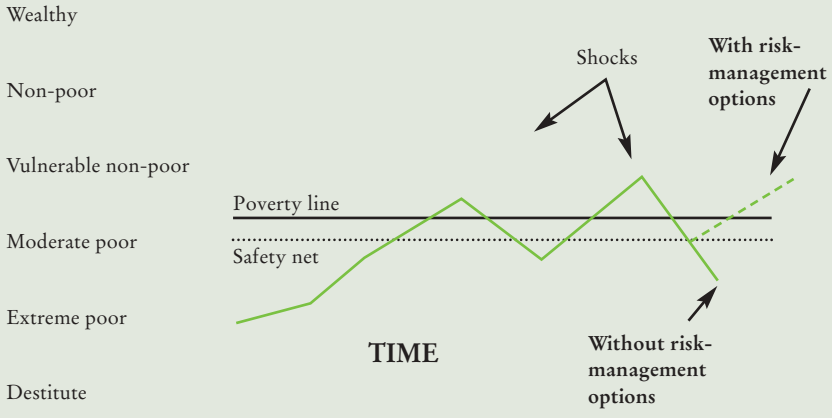
Monique Cohen and Jennefer Sebstad

The authors appreciate the insights and comments of Frank Bakx (Rabobank Foundation), Michal Matul (Micro Finance Center) and Michael McCord (MicroInsurance Centre).

Risk is ever present in the lives of the poor. Faced with shocks, poor people draw on their financial, physical, social and human assets to meet the resulting expenses. In the absence of precautionary or ex ante risk-management instruments, most are forced to rely on a range of options after the fact or ex post. When a crisis occurs, a common coping strategy is to borrow from the moneylender or microfinance institution; others might ask friends and relatives to help. Few have access to formal insurance services.

Poor people struggle endlessly to improve their lives. It is a slow and gradual process marked by tentative advances. Continually bombarded with financial pressures, low-income households find that shocks can easily erode their hard-earned gains. The result is that their trajectory out of poverty follows a zigzag route: advances reflect times of asset building and income growth; declines are the result of shocks and economic stresses that often push expenditure beyond current income *(Figure 2)*. The role of microinsur-

Figure 2 **Impact of shocks on household income and assets**



Source: Adapted from McCord, 2005.

ance, like any effective risk-management instrument, is to temper these downturns, which are major impediments to escaping poverty. Confronted with a shock, poor people usually patch together a variety of resources, including formal and informal credit and savings, and seeking out additional work or income-generating opportunities to meet their expenses. Understanding these risk-management strategies is a starting point for thinking about the demand for insurance by the poor. This chapter explores the risks to which low-income people are vulnerable, analyses their primary means of coping with or managing these risks, and provides insights into how insurance could enhance the ability of the poor to deal with risks.

1 Managing risk

1.1 Shocks and stress events

Vulnerability is closely associated with poverty and can be described as the ability of individuals and households to deal with risk.[1] The demand for microinsurance is directly related to vulnerability; it grows out of the risks and risk-management strategies of low-income households. Research on the impact of risk events and on how poor people cope with shocks helps illuminate the demand for insurance.

Risk comes in many forms, for example illness, death of a loved one, fire or theft. These shocks occur frequently and create pressures on household cash flow that exacerbate the ever-present stress of meeting regular expenses, such as food, rent and school fees. When financial pressures exceed the cash-flow capacity of the household, people must seek finance from outside sources. In some circumstances, microinsurance could be an option for filling this gap.

The difference between microinsurance and conventional insurance policyholders is that the former are poorer, have fewer financial reserves and have incomes that fluctuate considerably throughout the year. The poor are more vulnerable to such shocks because they have fewer resources not only to meet the immediate costs of the shock, but also the secondary expenses incurred in getting back on their feet *(Box 3)*. Once their reserves are depleted, low-income households are forced into increasingly reactive modes of behaviour. They respond to each crisis with increasingly stressful coping mechanisms *(Figure 3)*. The challenge for microinsurance is to turn reactive risk-management practices into proactive ones.

1 Risk is defined as the chance of a loss or a loss itself.

Box 3

Impact of shocks on the rich and poor in Viet Nam

Shocks that are minor for the non-poor can be devastating for those below the poverty line. In Viet Nam, the poor and rich can experience the same illnesses. However, compared to the wealthy, the poor tend to get sick more often, and therefore the costs are higher both in absolute terms and relative to household income. They also face difficult trade-offs: high health costs can also leave people with no money to send their children to school.

Source: Adapted from Tran and Yun, 2004.

1.2 Prioritizing risks

While across countries and in different markets within countries people prioritize risk differently, low-income households consistently identify the loss of a household income earner or sickness of a family member as their greatest concerns *(Table 2)*. Disability is also important but often subsumed under health. These shocks include both those that can be anticipated and those that cannot. Fortunately, many of the prevalent risks lend themselves to protection through insurance.

Table 2

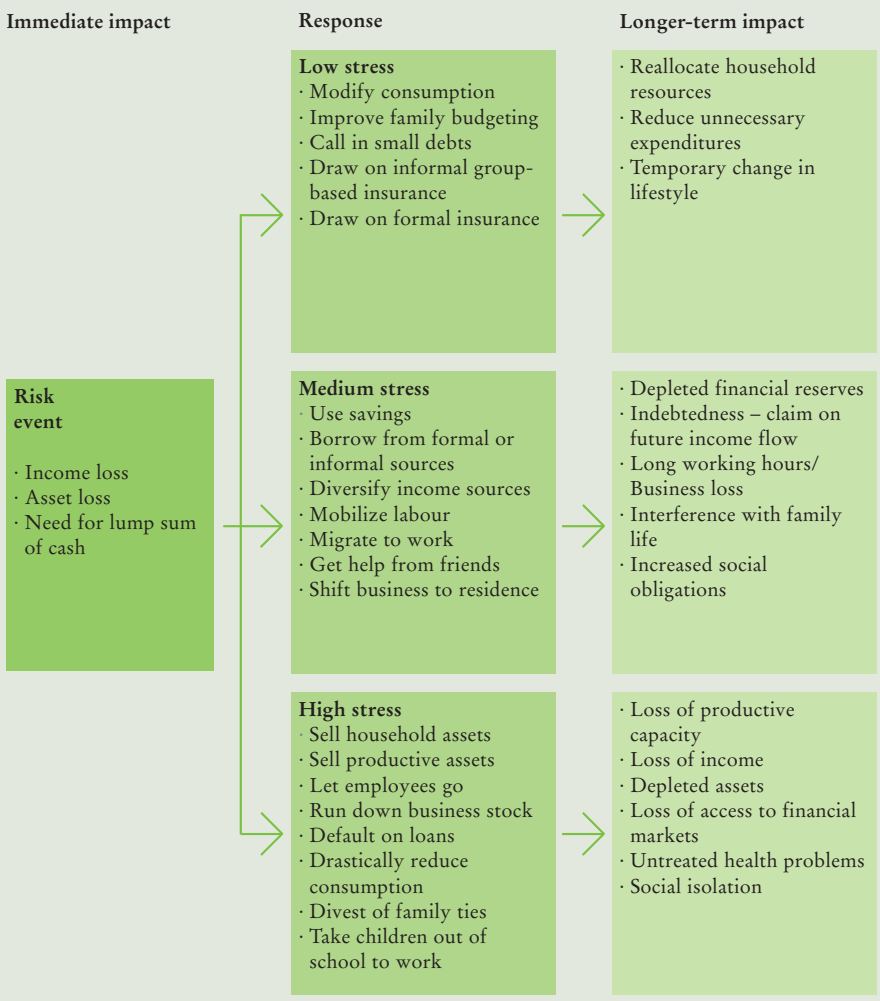
Priority risks in selected countries

Country	*Priority risk*
Uganda	Illness, death, disability, property loss, risk of loan
Malawi	Fear of death, especially in relation to HIV/AIDS, food insecurity, illness, education
Philippines	Death, old age, illness
Viet Nam	Illness, natural disaster, accidents, illness/death of livestock
Indonesia	Illness, children's education, poor harvest
Lao P.D.R.	Illness, livestock disease, death
Georgia	Illness, business losses, theft, death of family member, retirement income
Ukraine	Illness, disability, theft
Bolivia	Illness, death, property loss including crop loss in rural areas

Sources: Enarson and Wirén, 2005; Matul, 2004; Matul and Tounitsky, 2006; Mekong Economics, 2003; McCord, 2005; McCord et al., 2005b; Sebstad and Cohen, 2001.

While the dominance of illness is not surprising, it is easy to lose sight of its double impact in terms of the loss of income and added expenses. For families with sick children, small expenses can quickly mount up and have huge financial impact. Accidents, as well as chronic illness such as malaria and HIV/AIDS, require extremely large sums. These overwhelming financial pressures frequently fall on women, many of whom assume primary responsibility for the welfare of their families.

Figure 3 **The impact of risks**



Source: Cohen and Sebstad, 2005.

2 The importance of understanding the demand for microinsurance

Initial forays by insurance companies into the low-income insurance market have focused on downscaling existing formal insurance products. In the absence of market research, microinsurance providers have given limited attention to the match between products and consumer preferences. The result has been the supply of products that are not always well suited to the market. With this have come low persistence and renewal rates.

Improved understanding of demand enhances the design of appropriate products and identifies the steps that should be taken to ensure the adoption of these products by the poor. Market research improves the uptake of these unfamiliar services by determining what types of insurance low-income groups need, what types they can afford and what products it is feasible to deliver.

The range of topics for microinsurance demand research can be broad, depending on the intended use of the findings and the time and resources available. Research can be carried out at three levels, each dealing with a particular aspect of market demand: 1) understanding client needs, including their current risk-management behaviour, 2) product-specific research and 3) an analysis of the overall potential market.

The first level focuses on **understanding client needs** and what risks it makes sense to insure for different groups among the poor. It involves research on:

- key risks facing poor people,
- the impact of these risks,
- existing coping mechanisms,
- the effectiveness of the coping mechanisms,
- the role microinsurance (or other financial services) can play.

This level of research emphasizes current risk-management behaviour. Information on current practices and financial strategies households use to prepare for and respond to shocks helps to identify the vulnerabilities of the target market. A focus on existing coping mechanisms, and specifically group-based informal insurance mechanisms that involve risk pooling, can help to identify positive attributes of informal insurance systems that could be incorporated into the design of more formal microinsurance products. Understanding coping strategies can help to separate out risks that might be better addressed through savings and emergency loans. This type of research translates core needs into actual products by generating information that can be useful in identifying appropriate product attributes, such as the type and

amount of coverage, exclusions, delivery models, premium amounts, premium payment options, premium collection procedures and claims procedures.

The second level, **product-specific research,** can be carried out in conjunction with the development and testing of a product prototype and/or the actual delivery of an insurance product. Demand research on existing products, best undertaken after a product has been on the market for a while, addresses issues of customer satisfaction and loyalty. The focus is on people's adoption of the product, generating information that can be used in the design, delivery and affordability of new products or the refinement of existing ones. Emphasis is placed on the extent to which products match the needs, preferences and income capacity of low-income people (Sebstad et al., 2006).

The third level of research addresses the **size of the potential market** for a particular microinsurance product.[2] It estimates the number of potential policyholders in a particular geographic setting with potential demand and the capacity to pay. Of key importance is segmenting the market by particular types of insurance and estimating the incidence of the risk event for a particular population in a defined geographic location and within a specified time period. This information relates to the financial feasibility of an insurance product, the number of subscribers required for the product to be profitable, and pricing as well as other dimensions of a product within a market.[3] This level can also address current use and knowledge of insurance, attitudes towards insurance concepts and the insurance sector. Research on these issues helps to determine the potential market over the short and medium term. It also identifies those segments of the market that have specific usage and attitude problems with respect to microinsurance. This information can be used to formulate strategies to attract potential policyholders.

3 Current coping strategies: Strengths and weaknesses

In coping with shocks and stress events, precautionary measures are desirable but not always possible, especially for low-income households. Options for protecting against risks ahead of time may include:

- diversifying income sources,
- building assets by saving money, stocking food and investing in housing and healthcare,
- strengthening social networks,

2 The authors are indebted to Michal Matul for his contribution to this section.
3 This includes promotion, positioning, place, people and process.

- participating in reciprocal borrowing and lending systems, welfare associations and other informal group-based insurance systems,
- enrolling in formal insurance or pension schemes or other formal social security systems,
- managing money well by controlling consumption and maintaining access to multiple sources of credit.

All of these options are widely used; however, when cash flow is limited, poor households often manage shocks and stress events ex post *(see Box 4)*.

Box 4

Risks and risk management in Malawi

People in Malawi are very much aware that improving the health of individuals and animals is the best precaution against disease. However, in this very poor country, the lack of both health and veterinary services and access to appropriate financial services is an obstacle. In addition, Malawians find that the lack of transport and poor communications also restrict their capacity to cope with risk.

Source: Adapted from Enarsson and Wirén, 2005.

The options for coping with losses ex post are both extensive and creative. Some long-standing, informal and self-insurance risk-management tools have been adapted over the years to respond to new diseases such as HIV/AIDS, new pressures such as the privatization of the health system and changes in the financial services market. Aspects of each can work for low-income households, although the levels of coverage and effectiveness will vary depending on the option. Few low-income households limit themselves to one risk-management instrument. They mix and match various options depending on the risk, the loss and their cash flow *(see Box 5)*.

Box 5

Coping strategies in Viet Nam

In Viet Nam, loans are often used for healthcare. Sales of pigs, important assets, are often used to pay expenses such as school fees. Cash savings can be important, but they are limited. Cash kept at home is risky because of the continual pressure on its use. Next in importance is saving in a group, like a rotating savings and credit association (ROSCA), even though this is seen primarily as a precautionary mechanism.

Source: Adapted from Mekong Economics, 2003.

As illustrated in Table 3, both ex ante strategies (precautionary) and ex post strategies (managing a loss) for dealing with risk generally involve a mix of intra-household measures (self-insurance) and inter-household, group-based measures (informal and formal insurance). The types and mix of strategies an individual or household uses at any given time will reflect its level of vulnerability. The pros and cons of these risk-management instruments are discussed below.

Table 3 **Coping strategy by risk**

Coping strategies	*Risks* *Death*	*Health*	*Property*
Self-insurance	Financial services Money lender	Financial services Current income Family/friends Sell/pledge assets Money lender Reduced consumption	Financial services Current income Sell assets Precautionary measures
Informal group-based mechanisms	Welfare associations (funeral societies) ROSCAs	Welfare associations Borrow from church groups Fund raisers ROSCAs	Welfare associations Vigilante groups Hiring of guards
Formal insurance	Partnerships between insurers and MFIs	Partnerships between insurers and MFIs purchase health insurance	Partnerships between insurers and MFIs purchase property insurance
Social protection		Health services Disability compensation	Police

3.1 Self-insurance

Self-insurance, which does not have a risk-pooling mechanism, is a common risk-management strategy for people at all income levels. For example, economic stresses that cause a short-term increase in household expenses can often be mitigated with credit, savings or additional income. Generally these mechanisms work best in situations where risks have a high probability of occurring and cause relatively small losses.

Drawing on savings is less expensive than using credit for expected needs. Yet, this savings strategy also is limited. Many poor households have difficulty amassing sufficient funds to manage risks adequately. Those that have sav-

ings are reluctant to draw on them as they strive to preserve these hard-earned assets for earmarked purposes, such as investing in a business or building a house (Sebstad and Cohen, 2001). A study in Tanzania found that many people with significant savings prefer to borrow rather than draw on these savings when faced with an unexpected demand (Millinga, 2002). In Bolivia, many of the urban poor borrow as an instant response to a crisis. (Velasco and del Granado, 2004). By contrast, in South Africa, savings play a key role in risk management (Bester et al., 2004).

In general, credit is ill suited for larger losses, such as expensive healthcare shocks and catastrophic events that affect large numbers of people at the same time. Protection against these losses requires other forms of social protection, disaster assistance or public support (Churchill, 2005; Siegel et al., 2001). One area where credit has proved effective in managing risk is through emergency loans, such as those introduced by CIDR in Mali. A highly popular financial product in rural areas, the funds are tapped to overcome a common hurdle in accessing healthcare, i.e. the need to pay for transport to a medical centre. Ensuring access to multiple sources of microcredit in an emergency is another risk-management strategy, but there are limitations. Clients in the middle of repaying one loan may not be allowed to borrow extra funds from the same source. They are also at risk of assuming more debt than they can handle *(see Box 6)*.

Box 6

Risk management and over-indebtedness in Georgia

Research from Georgia shows that the most common risk-management strategies involve excessive borrowing and the liquidation of household assets. Over the long run, increasing over-indebtedness and a shrinking household asset base increases a household's vulnerability to poverty. This is a particular phenomenon in transition countries where the new poor, slow to develop their own coping strategies, still expect inefficient governments to help them.

Source: Adapted from Matul, 2004.

Borrowing from family and friends is widely acknowledged as a strategy for meeting unanticipated shocks. However, the amounts of money are usually small and not always available, especially when prospective benefactors experience the same crisis. The source of support also comes with expectations of reciprocity, which can create longer-term pressures.

When people respond to a crisis by borrowing, repayments place a claim on future income. If income dips, households may be forced to mobilize labour (including children), sell assets or go even further into debt. Defaulting on the loan is rarely perceived as a viable option. The poor generally go

to great lengths to maintain their access to microcredit, if only to be assured access to a lump sum in future times of need (Sebstad and Cohen, 2001).

Depletion of assets is a last resort. With it goes the loss of the household's productive base and capacity to generate future income. When productive assets are sold, resuming productive activities is much more difficult and stressful. As observed in Albania, crises often require selling productive assets and inventory at great discounts to pay expenses and debt. The household is then doubly punished when it seeks the money to repurchase the assets. Repeated shocks combined with depleted reserves to reduce the household's ability to resume productive activities, recover and cope with future risks (Szubert, 2004).

People also self-insure through other precautionary measures. In East Africa, shopkeepers invest in burglar bars on windows and night watchmen; alternatively, they sleep in their shops or simply take their inventory home with them (Cohen and Sebstad, 2005).

3.2 Informal group-based mechanisms

Low-income households in many countries use diverse types of welfare associations for sharing risk *(Table 4)*. Their underlying basis is reciprocal exchange in times of need. Ethnically or geographically based welfare associations help their members manage cash flow or pool risk. Many are governed by well-defined charters and require payment of dues in return for the right to access group resources, in cash or in kind, for a specified need.

Table 4 **Examples of informal group-based insurance systems**

Country	*Name of welfare association*	*Function*
Uganda	*Munno mukabi* (friends in need)	Covering funeral requirements including food for guests and embalming of the body
Philippines	*Damayan*	Welfare/burial societies
South Africa	Funeral or burial societies[4]	Emotional support, helping hands
Indonesia	*Arisans*	Health insurance

When a death occurs, welfare associations are particularly adept at responding quickly. A major weakness can be the limited coverage provided

[4] Funeral or burial societies are distinct from funeral parlours, which deal with the body, and from funeral insurance, which provides cash support, although some funeral parlours offer insurance with an in-kind benefit.

by a single burial society; also a series of shocks can deplete its reserves. As a result, households often belong to multiple associations and incur the high transaction costs that accompany each membership *(see Box 7)*.

Box 7

Membership in multiple burial societies

In South Africa, people willingly hold numerous policies, because each may be insufficient or provide different funeral coverage. Membership of numerous welfare associations is also common. The first is intended to cover the funeral costs, the second to provide food for the children and the third one is for the secondary impacts, to keep food on the table, keep the children in school and help the household recover.

Source: Adapted from Bester et al., 2004.

Households sometimes fall out of informal group-based funeral societies in their communities because they are socially excluded or too poor to participate. In the absence of this support, life insurance is often a more important need than among those who are not socially or economically excluded.

Informal group-based mechanisms also include ROSCAs and accumulating savings and credit associations (ASCAs), which are used as a way to save. Depending on the size of the cash contribution, they can be useful when a relatively large amount of cash is needed. However, these mechanisms may not be sufficiently flexible to provide the funds when they are most needed, since members often need to wait their turn. In Indonesia, members faced with an emergency can apply to take their turn early, but receive only a discounted amount (McCord et al., 2005b). In situations where the ROSCA mechanism is not sufficiently responsive to emergencies, however, membership of such a group often creates social capital on which the members can draw in times of need.

3.3 Formal insurance

Microinsurance is a new option for low-income households. Designed primarily to provide protection for health and death expenses, these new products so far have met with varying degrees of success. Poor individuals and households at or around the poverty line are the primary target market. Those households well below the poverty line are most in need of insurance, but it may be unaffordable for them.

The most common form of microinsurance is credit life. As discussed in Chapter 2.3, it is common in credit unions and other MFIs for the outstanding balance of a loan to be covered should a client die. While credit life can be a good source of revenue for an MFI, policyholders often question the value

of the credit-life product and see the primary purpose as being to protect the lender, not the borrowers.[5]

Funeral insurance *(see also Chapter 2.3)* is popular, especially in countries where the high cost of burials or funerals can put a family heavily into debt *(see Box 8)*.

Box 8

High cost of funerals in Zambia

Madison Insurance in Zambia has developed a funeral insurance product that is distributed through MFIs. Since funerals in Zambia can cost between US$300 and US$500 (the GDP per capita is US$900), this was a welcome addition to the financial services offered to the poor. In the words of one client: "Thandizo (the insurance product) is one of the best services I have received from Pulse (one of Madison's MFI agents). For the insured members of my house, I am assured I will not have to struggle to meet funeral costs, and my business income is spared."

Source: Adapted from Manje, 2005.

In some parts of Africa and elsewhere, women are especially vulnerable following the death of a husband when they lose their property to other relatives (in the absence of property rights or knowledge of ways to exercise their property rights). For many women, their priority is life insurance for their husbands. In the event of their own death, women fear that their husbands may use an insurance payout intended for the children's education to invest in a new wife. Increasingly, women prepare for their own death by designating their friends as beneficiaries and instructing them to use the money for the children's school fees and other necessities (Cohen and Sebstad, 2005).

Health insurance is in high demand, but difficult to deliver *(see Chapter 2.1)*. Households want comprehensive coverage, but often lack both the capacity to pay and access to quality services. As rural Nepalis noted, "in the absence of good health services, paying for health insurance is simply a waste" (Simkhada, et al., 2000). Furthermore, as discussed in Chapter 1.3, the role of the state in the provision of health insurance cannot be ignored. It will continue to be important in determining the likely role of health insurance in many countries.

Despite its potential, the effective demand for microinsurance is still unclear. Many microinsurance products are bundled with loans, and the

5 There is considerable support for this argument. The number of claims paid annually is usually very small. In addition, many MFIs set age ceilings for borrowing, ensuring that clients are out of the programme before they become high death risks.

premium is included as a fee paid at the time of loan disbursement. This has two effects: 1) people are often unaware of how much they are paying and what they are actually paying for and 2) when clients stop borrowing, they generally lose their insurance coverage.

3.4 Social protection

For many of the working poor, government health services could be an option to cover health and disability risks. However, many poor households prefer private services to low-quality public healthcare. Indeed, with low-income households bearing as much as 80 per cent of their health costs in some countries, many poor people see an obvious opportunity for microinsurance (McCord, 2005).

In transition countries, the decline of universal social protection has left a different gap and opportunity for microinsurance. Despite the declining role of the state in the provision of healthcare, people's behaviour has lagged behind. Few households budget for their health expenses (Matul, 2006).

Governments have a role in allocating funds to protect the destitute and those with no ability to generate sufficient funds for risk management. Private insurance will never be an option for this market.

4 Opportunities for microinsurance

In deciding where microinsurance can most effectively fit into the mix of risk-management strategies, it is first necessary to determine which risks best lend themselves to insurance. The ICMIF test for an insurable risk suggests one approach *(Table 5)*.

The next question is where microinsurance can add value for the client. The above review suggests that managing risk is currently an ex post rather than an ex ante activity for low-income households. Self-insurance is the most common risk-management option, but its effectiveness is limited because it generally covers only a small portion of the loss. This has a negative effect on income and assets in the short term, and on the capacity to manage future risks in the longer term. People often get by with great difficulty, trying to stay one step ahead of the next crisis. By increasing the portion of the loss covered, insurance could meet a need and reduce the stresses associated with poverty.

Table 5

Test for an insurable risk

- ☐ Does the loss occur by chance?
- ☐ Is the loss definite in time and amount?
- ☐ Does the loss create significant hardship relative to income?
- ☐ Are a large number of similar units exposed to the risk?
- ☐ Is it possible to estimate the possibility of the loss occurring?
- ☐ Will the risk pool attract sufficient numbers of clients who are unlikely to submit claims (does it meet the criteria for adverse selection)?
- ☐ Is the loss a genuine loss to the insured (no house, no house insurance)?
- ☐ Is the loss one that will not be catastrophic to the insurer? Does the same risk affect more than one person or household at a time? Is it idiosyncratic?

Source: ICMIF, 2005.

Analysts of demand data need to be discriminating in interpreting the findings. While poor people experience many risks and their coping mechanisms are imperfect, this does not necessarily translate into demand for insurance. Experience with informal group-based insurance is not always transferable to microinsurance. For example, according to McCord and Buczkowski (2004), even though the members of CARD MBA in the Philippines participate in damayan-type schemes, they have little knowledge of formal insurance concepts and products.

The review of risk-management strategies provides insight into the product attributes that might be integrated into the design and delivery of microinsurance products. This section considers six aspects of insurance demand: 1) coverage, 2) accessibility, 3) timeliness, 4) pricing and affordability, 5) client education and 6) market segmentation.

4.1 Coverage

Health coverage is a top priority for low-income households in most countries. The most common insurance products available to the poor include life and funeral insurance. On a smaller scale, there are initiatives concerned with health protection, livestock, crop and property insurance.

While the level of coverage varies for different products, typically no single form of insurance provides full coverage to low-income households. Many clients would prefer more coverage, but cannot afford it. In South Africa, where funeral insurance is available, the cost of funerals is most often covered by income, savings, borrowing and gifts, in that order. Insurance benefits, in cash and in kind, come fifth and sixth and account for less than 20 per cent of the expenses (Financial Diaries, 2005).

Even with access to insurance, low-income households will continue to cover the costs of shocks from a mix of financial services, i.e. formal, informal and self-insurance. In developing insurance products, it is important to recognize the complementarities among different financial services, as well as different institutional providers of social protection, to see how they might work together to better manage risks.

While disability risk is covered by some policies, insurance usually provides a one-off payment rather than a replacement for loss of income or salary. Thus, only a part of the loss is covered. This creates high stress for the working poor when health risks affect their ability to earn income.

Flexible schemes that offer different levels and types of coverage provide people with more options, but can be more complex to administer and require more client and staff education. Coverage levels and product features, especially policy exclusions, are rarely explained or fully understood by the target market. For example, in Uganda, policyholders' lack of knowledge about the insurance product was consistent across the MFIs that offer coverage backed by AIG Uganda. Many were not aware of all of the product's benefits, and they often did not distinguish between family members covered by the policy and the person who is to receive the cash payout if the policyholder dies by accident. They considered all of them as beneficiaries of insurance (McCord et al., 2005a).

4.2 Accessibility

Self-insurance is the only option open to everyone. Group-based informal insurance depends on trust and reciprocity, features that also have been important to the success of solidarity group lending. Access is closely associated with being part of a social network. The groups provide the basis for risk pooling and a platform for administering regular contributions and payouts. Membership in a group is an important way that poor people build social capital and access informal insurance. The extent to which existing groups might provide an institutional base for expanding the outreach and access to microinsurance is unknown. Some mutual health schemes have pursued this route *(see Chapter 4.3)*.

The ability to obtain birth and death certificates or identity cards also affects the accessibility of microinsurance. Providing claims documentation can be even more challenging for poor people in remote areas where bureaucratic systems do not function well, or in areas where civil conflict affects the security and mobility of people. Complex payment and claims processes can also affect accessibility. Formal insurance is frequently plagued with claim payout problems. The claims process is often too complex and impersonal

for people whose previous experience with risk-management instruments is with their communal welfare associations.

To date, MFIs have played an important role in developing microinsurance and making it accessible to low-income groups. The advantage is their outreach to the poor. One limitation, however, is that not all types of insurance are relevant to the interests of the MFI (in terms of reducing arrears). Another limitation is that microinsurance policies for many microcredit providers are linked to their loans and therefore available only to their clients. If microinsurance is to be open to all low-income households, it is essential for credit and insurance to be de-linked and for the payment of the premium to be separate from the disbursement of loans.

4.3 Timeliness

By definition, low-income households are vulnerable to shocks because they lack cash reserves to cover immediate expenses. Consequently, the timeliness of claim payments is crucial for product adoption. People in eastern and southern Africa prefer welfare associations because they require little or no paperwork to verify a death, and payouts can be immediately available. In contrast, claim payments by insurance companies can take months.

4.4 Pricing and affordability

Evidence shows that demand for microinsurance is high and there is a willingness to pay. In some countries, people are particularly interested in insurance that is coupled with asset building. In Indonesia, for example, the first priority is an insured savings product for education, with payouts made as needed to cover selected school fees (McCord et al., 2005b).

With microinsurance consumers increasingly discerning and heterogeneous, there is a need for premium payments to be structured in ways that make sense to the policyholders. As discussed in Chapter 3.3, insurance providers would do well to match the premium payments to the cash flow of low-income households. In this respect, informal mechanisms have proven more responsive to client needs than many current microinsurance providers. For example, in Albania, Opportunity International found that an existing insurance product failed not because the terms and pricing were unacceptable, but because the premium had to be paid in advance. The up-front payment requirements were not in line with the potential policyholders' cash flow (Leftley, 2002).

So what is the capacity to pay? This is difficult to determine. As Matul and Tounitsky (2006) have noted, this is not only a function of income levels but also very subjective. The level of financial literacy strongly influences what people think they can afford; client education on the insurance product influences what people think they are getting for the price.

There is mounting evidence that some policyholders are very sensitive to the value of the costs and benefits of a microinsurance policy. Across three countries in West Africa, CIDR found that the contribution of household income to health insurance is consistently between 1.5 and 2.5 per cent of household income. When the premium price is raised above 2 per cent, households adjust by reducing the number of household members covered by insurance, rather than increasing their premium payments (Galland, 2005a). In Ukraine, market research showed that a decrease in the premium by 30 per cent was met by a 10 per cent increase in policyholders (Matul, 2006). Indeed, market research is critical to better understand ability and willingness to pay *(see Box 9)*.

Box 9

Understanding the demand for microinsurance in Sri Lanka

Yasiru policyholders in Sri Lanka found that the benefit payments were not proportionate to premiums that they were paying and that the insurance policy did not clearly define the number of family members covered. An assessment of client preferences led to policy adjustments to ensure that premiums better matched benefits and the relationship between premiums and the number of family members covered was clearer.

Source: Adapted from Fokoma, 2004.

Poverty limits the number of financial obligations a person can take on. Experience from an MFI-linked insurance scheme in Nepal suggests that many poor households find the burden of an insurance premium on top of a loan repayment to be a strain. Policyholders who already had health insurance were unwilling to pay a second premium for voluntary life insurance (CMF, 2005). However, the mandatory nature of many insurance products makes it difficult to predict the demand (and willingness to pay) among poor households for voluntary insurance at different premium levels.

4.5 Insurance education

Risk management by the poor is not new, but for many people insurance as a risk-mitigation instrument is. As a result, its adoption presents a challenge to clients and sales agents. Among those who have heard about insurance, there is considerable scepticism. For many low-income households, insurance is

seen as the province of the rich. Indeed, confidence in the insurance industry is often low and negative perceptions abound. There is a reluctance to pay in advance for services one may not receive, especially an intangible service that one may not even understand. For those who have had experience with insurance or have heard about the experiences of others, the limited scope of coverage and the long delays in settling claims exacerbate the negative perception. In some cultures, it is not always socially acceptable to bet on negative events: any focus on illness and death is seen as wishing for bad luck.

If microinsurance is to succeed, there is a vital need for strategic investments in consumer education to change these perceptions. The knowledge and attitudes of low-income households and insurance agents need to be improved. While some organizations selling microinsurance give potential policyholders information describing the premium, benefits and claims procedures, this has limited value if the policyholders – and often the insurance agents – lack a basic understanding of insurance and risk management. As illustrated in Box 10, many poor persons are interested in learning more about insurance.

The success of microinsurance adoption is not simply a function of making certain that products are appropriate and affordable, but is also dependent on a level of financial literacy that enables consumers to assess what they are getting when they pay a premium. Changing the consumer's knowledge, skills and attitudes toward insurance, and creating an insurance culture, are important in facilitating the adoption of this formal financial service.

Box 10

We want to know more …

1. Malawi

While the MUSCCO members were aware of insurance, they did not necessarily know what an insurance policy was. They wanted more information about insurance, including its costs and benefits (Enarsson and Wirén, 2005).

2. Uganda

Most policyholders did not know how much they were paying, what was covered or how to make claims. The insurance agent (an MFI staff person) also knew little and therefore could rarely be of much help (Cohen and Sebstad, 2005).

3. Guatemala

Columna policyholders said that they wanted to be better informed, but the institution failed to provide them with more information (Herrera and Miranda, 2004).

4.6 One size does not fit all

Demand research shows that generalizing across countries and regions is risky when considering the attributes of risk-managing financial services. One size does not fit all. For example, in Nepal and Indonesia there is limited demand for life and funeral insurance as funeral expenses are kept at a level that the family can afford (Simkhada et al., 2000; McCord et al., 2005b). By contrast, life and funeral insurance are very much in demand in Uganda and South Africa. In both countries, there are high levels of expenditure on the rites associated with funerals; meanwhile traditional systems of community support have been under a lot of stress, especially in regions affected by HIV/AIDS (Sebageni, 2003; Bester et al., 2004).

Demand studies also reveal different insurance priorities for different market segments. The one-size-fits-all approach that characterizes the design of many life insurance products does not typically consider differences in gender, location or life-cycle position of the policyholder. For example, for poor middle-aged women, life cover for their spouses is likely to have a higher priority than cover for their own lives.[6] SEWA Bank clients in India made this point and were successful in securing life insurance policies for their husbands even though the bank manager assumed they would find it unaffordable. As alternative delivery channels are used to reach the working poor, such as those described in Chapters 4.5 and 4.5, other market segments will be reached, bringing a demand for different products or product features.

The experience of low-income households illustrates the importance of complementary activities across different market segments, not only to mitigate losses resulting from insurable risks (e.g. loss of life), but also to help build and protect assets – thereby strengthening the longer-term capacity of households to manage risks. Stress events such as weddings, payment of school fees and housing expenses often exert great financial pressure, especially for women. Insured savings or endowments offer potential solutions. These endowment products, offered by insurance companies in Indonesia, Bangladesh and Ghana, for example, have proved popular among the poor (though less so in Sri Lanka). They build assets while protecting people against potential losses. However, they are not without the risks associated with long-term macroeconomic and corporate stability, and may not be the most cost-effective way for the poor to manage risks *(see Chapter 2.2)*.

6 Many microfinance borrowers fit this profile, but the MFI's rules may require her to leave the programme at 55 or 60, at which time she will stop contributing to life insurance and her children will no longer receive benefits should she die. Under these circumstances, what does she have to gain from a life insurance policy?

5 Conclusion

The growing number of demand studies is beginning to provide a credible base of information which can be used to estimate market demand and help design appropriate products in selected countries. This is enabling service providers to move away from simply downsizing existing insurance products originally aimed at the middle class to developing products and services that work for the "bottom of the pyramid".

The market for microinsurance is large. All stakeholders, insurance companies, their agents and policyholders have much to gain from this market being served well. However, getting everyone working together will take time. In the absence of a strong insurance culture among low-income households, client demand in many places is still evolving. Where insurance has worked well for low-income households – where the coverage is appropriate, accessible, affordable and well understood – it has been met with considerable and growing success. It reduces risk and vulnerability in the lives of poor people, allowing them to move from reactive to proactive behaviour and thus plan for the future. With more financial control, poor people have more options. Research on client demand can continue to play a key role in the development of successful microinsurance products.

1.3 The social protection perspective on microinsurance

Christian Jacquier, Gabriele Ramm, Philippe Marcadent and Valérie Schmitt-Diabate[1]

The authors appreciate the comments provided by Bruno Galland (CIDR) and Rüdiger Krech (GTZ).

1 Introduction

Access to social security is a fundamental human right. Moreover, social security and social protection are increasingly recognized in the global debate as indispensable components of poverty reduction, sustainable economic development, fair globalization and decent work. In this respect, the World Commission on the Social Dimension of Globalization stresses that a minimum amount of social protection must be accepted as being an integral part of the socio-economic base of the global economy. Social protection is also a key tool for the attainment of the Millenium Development Goals (MDGs).

Therefore, social protection is much more than a risk-management instrument for individuals. It is a comprehensive, collective tool to reduce poverty, inequality and vulnerability. It promotes equity and solidarity through redistribution. And it provides fair access to healthcare, income security and basic social services. However, more than half of the world's population does not benefit from any form of social protection.

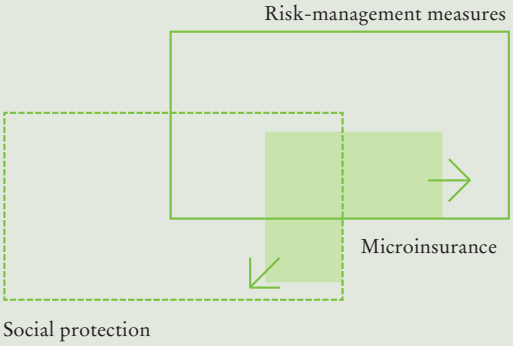
Facing exclusion from social protection, local communities are taking initiatives to organize microinsurance schemes. Microinsurance is delivered through a diversity of organizations covering various risks or contingencies including health, maternity, life and disability. Some schemes are not just risk-management instruments, but have the potential to contribute to the extension of social protection to excluded groups. Furthermore, these schemes can improve the governance of social protection providers (e.g. healthcare) and raise supplementary resources that enhance social protection as a whole. This is particularly necessary where the state has limited financial and institutional capacity.

[1] This chapter is adapted from a forthcoming publication by the ILO and GTZ entitled *The role of microinsurance as a tool to face risks in the context of social protection*. Examples from Senegal are drawn from the authors' experiences.

Microinsurance schemes can be components of social protection systems, as illustrated in Figure 4, although this has several implications:

- Microinsurance schemes may assume some social protection functions, such as redistribution through internal cross-subsidies or by channelling public subsidies to their members.
- Microinsurance schemes should not only be evaluated on technical aspects (e.g. financial viability), but also on their capacity to reach social protection outcomes; the socio-economic impact of these schemes on members and non-members should be taken into consideration.
- A non-regulated market may fail to provide an efficient benefit package for the poor.
- Microinsurance schemes can play an important role in the empowerment and participation of their members, which has implications in terms of the design of the products, the choice of the benefit package, affordability and the organization of the schemes.

Figure 4 **The locus of microinsurance**



However, stand-alone, self-financed microinsurance schemes have major limitations on their ability to be sustainable and efficient social protection mechanisms capable of reaching large segments of the excluded populations. Their potential to extend social protection is increased when governments include them in national social protection strategies, linking them to other social protection components to create a progressively more coherent, efficient and equitable system.

This chapter explores the relationship between social protection and microinsurance by first defining social security and social protection. Within that context, the chapter then defines microinsurance, and goes on to illustrate its potential and limitations. Finally, it provides some illustrations of how microinsurance can be used to extend social protection to excluded populations and to overcome some of the inherent limitations.

2 What is social security? What is social protection?

2.1 Definition, objectives and key functions

According to the ILO (2000), **social security** is the protection which society provides for its members through a series of public measures:

- to compensate for the absence or substantial reduction of income from work resulting from various contingencies (notably sickness, maternity, employment injury, unemployment, invalidity, old age and death of the breadwinner),
- to provide people with healthcare,
- to provide benefits for families with children.[2]

Social protection includes not only public social security schemes but also private or non-statutory schemes with similar objectives, such as mutual benefit societies and occupational pension schemes, provided that the contributions to these schemes are not wholly determined by market forces.

This definition of social protection is one of several approaches. Other organizations, such as the World Bank and the Asian Development Bank, use more holistic conceptions of social protection ("social risk management"). They include a larger range of contingencies – anything that affects individuals' income security – which naturally overlaps with other sector policies, such as education or labour. This broader view not only includes protecting mechanisms, but also promotional interventions to increase assets or economic opportunities (such as microfinance programmes, price supports or commodity subsidies). Indeed, the concepts of social protection are still under discussion, for example in the Network on Poverty Reduction facilitated by OECD's Development Assistance Committee.

Regardless of the specific definition, social protection is an important tool to prevent poverty and strengthen the capacity of the poor to get out of poverty. For instance, some social protection measures consist of a direct transfer of funds to the poorest (identified through means testing), which has

[2] The ILO has a number of social security conventions that deal with the practical implementation of this human right. The most important is the Social Security (Minimum Standards) Convention, 1952 (No. 102). It defines nine branches of social security and the corresponding contingencies covered: medical care, sickness benefit, unemployment benefit, old-age benefit, employment injury benefit, family benefit, maternity benefit, invalidity benefit and survivors' benefit. In addition, it introduces the idea of a minimum level of social security that must be achieved by all member states. To take into account different national situations, ILO conventions on social security typically contain flexibility clauses regarding the population covered, and the scope and level of benefits provided. They also give states full discretion in the organization of their social security scheme. In other words, these conventions affirm the right of everyone to social security, but recognize the practical difficulties in actually implementing this right in the social realities that prevail worldwide.

a direct and at least temporary effect on poverty. Social protection also reduces poverty through its positive impact on economic performance and productivity. It can be seen as a productive factor for three main reasons (ILO, 2005b):

1. Social protection helps people to **cope with important risks** and loss of income. In doing so, it can enhance and maintain the productivity of workers and create possibilities for new employment. For instance, healthcare systems help maintain workers in good health and cure those who become sick. Similarly, work injury schemes help prevent accidents and sickness and rehabilitate injured workers.
2. Social protection can be a critical tool in **managing change in the economy** and the labour market. For instance, unemployment insurance creates a feeling of security among the workforce, which encourages individuals to undertake riskier initiatives that may result in a higher return for them and for the economy.
3. Social protection can **stabilize the economy** by providing replacement income that smoothes out consumption in recessions, thus preventing a deepening of recessions due to collapsing consumer confidence and its negative effects on domestic demand. For instance, unemployment benefits and old-age pensions help to maintain the purchasing power of workers after they have lost their jobs or retired.

Social protection can enhance principles such as solidarity, dignity and equality. **Solidarity** arises when everyone contributes to a common pot according to their capacity and draws from this pot according to their needs (within the limits fixed by the internal rules of the scheme). Solidarity can also materialize through the redistribution of funds raised through taxes. The level of solidarity depends on the nature of the financing instruments that are being used: while income tax or income-related contributions are usually progressive, consumption taxes or flat-rate premiums run the risk of being regressive.

Social protection is linked with the principle of **dignity** since it gives people the right to live a decent life whatever adverse events afflict them. Unlike charity, social protection integrates individuals in a process of exchange, where they have the right to receive and the obligation to give. Their dignity is recognized by allowing people the possibility to contribute. Social protection is also linked with the principle of **equality** (including gender equality) and non-discrimination when equal rights are given to all people exposed to the same risks or supporting the same burdens without discrimination.

The application of the principles of solidarity, dignity and equality within

social protection help to foster social cohesion, inclusion and peace, which are prerequisites for stable long-term economic growth. Furthermore, the integrative role of social protection brings individuals or groups that have been excluded into the mainstream by providing support in accessing employment and becoming active, and possibly tax-paying, members of society (Piron, 2004). Social protection can finally be a tool to promote empowerment and participation through the representation of workers in the formal economy (within statutory social protection schemes) and informal economy (within community-based social protection schemes). This participation is one way of enhancing democracy.

The ILO's conception of social protection (definition, functions) is shared by many institutions worldwide. Recently, the most important international federations and organizations representing the cooperative and mutual insurance sector formed the International Alliance for the Extension of Social Protection.[3] Their shared vision, values and principles are articulated in "the Geneva Consensus" 2005, which recognizes that "social security is a fundamental and universal human right". This consensus also enumerates basic principles and values regarding social protection – such as solidarity, redistribution, role in economic and social development, importance of efficiency, relevance, good governance and financial viability – and suggests that the values of the cooperative and mutualist movement be held in high regard (e.g. social justice, absence of exclusion and discrimination, non profit, participation and empowerment).

2.2 Gaps between right and reality

The definition of social security as a human right starts from the principles of universality and equality: every human being is equally entitled to social security, which has two major implications.

1. States have an obligation to take measures to guarantee this right.
They have to take appropriate legislative, administrative, budgetary, judicial or other measures to ensure that the right is guaranteed to their populations. This obligation does not necessarily mean that the state has to provide social protection directly; it can facilitate or encourage actions of third parties. Obligation can be of conduct: states have to take the necessary steps to guar-

[3] The members include: ISSA (International Social Security Association), AIM (Association Internationale de la Mutualité), ICA (International Cooperative Alliance), ICMIF (International Co-operative and Mutual Insurance Federation), IHCO (International Health Co-operative Organization), WIEGO (Women in Informal Employment: Globalizing and Organizing) and the ILO. For more details about the International Alliance, see www.social-protection.org.

antee a particular right. Obligation can also be of result: states have to achieve specific targets to satisfy a specific standard. In addition, there is an obligation of the international community, so far unofficially recognized, to support states with insufficient resources to guarantee human rights, including the right to social security. This is in line with the idea behind the Global Fund for Malaria, Tuberculosis and HIV/AIDS.

2. Everybody is entitled to a minimum level of social protection, w**ithout exception or discrimination.** This entitlement includes an equitable access to social protection, independent of individuals' age, sex, health status, location, occupation or income level. This entitlement to a minimum level of social protection is often used to justify the design and implementation of equity subsidies from the rich to the poor.

Yet in many developing countries, social protection coverage is dramatically low: it reaches only a small proportion of the population and provides protection against only a limited range of risks. In sub-Saharan Africa and South Asia, only 5 to 10 per cent of the population is covered by a statutory social security scheme, primarily old-age pension schemes and access to healthcare (ILO, 2001). In some countries, the percentage of the population covered is even shrinking due to structural adjustment policies, privatization and the development of the informal economy. Although some excluded people work in the formal sector, the vast majority are active in the informal economy.

Until the last decade, social protection strategies were based on the assumption that the formal economy would progressively gain ground on the traditional economy, and therefore social security would progressively cover a larger proportion of the workforce. However, this has not happened. In many developing countries, most of the jobs created during the last decade have been in the informal economy (ILO, 2002a). Today, informal employment comprises one half to three quarters of non-agricultural employment in developing countries. If informal employment in agriculture is included in the estimates, the proportion of informal employment increases significantly, for example from 83 to 93 per cent in India, from 55 to 62 per cent in Mexico, and from 23 to 34 per cent in South Africa (ILO, 2001). Although some states have tried, so far attempts to extend the coverage of statutory social security to workers in the informal economy have been insufficient.

2.3 Priority to extend social protection coverage

It is therefore necessary to find other ways to translate the right to social protection into reality. At the International Labour Conference in 2001, governments and employers' and workers' organizations representing 160 countries agreed upon a new consensus on social security; they agreed notably that highest priority should be given to policies and initiatives to extend social security to those who have none, and they proposed several ways of accomplishing that objective:

When these groups cannot be immediately provided with coverage, insurance – where appropriate on a voluntary basis – or other measures such as social assistance could be introduced and extended and integrated into the social security system at a later stage when the value of the benefits has been demonstrated and it is economically sustainable to do so. Certain groups have different needs and some have very low contributory capacity. The successful extension of social security requires that these differences be taken into account. The potential of microinsurance should also be rigorously explored: even if it cannot be the basis of a comprehensive social security system, it could be a useful first step, particularly in responding to people's urgent need for improved access to healthcare. Policies and initiatives on the extension of coverage should be taken within the context of an integrated national social security strategy (ILO, 2001).

At the suggestion of the Conference, in 2003 the ILO launched the "Global Campaign on Social Security and Coverage for All".

When faced with the present situation where a large (and growing) number of persons are excluded from social protection, it is necessary to devise proactive strategies to extend it. These strategies aim at increasing the number of persons covered and at improving the level and the scope of existing social protection benefits. A range of mechanisms can be used to implement these strategies, for instance:

- Social insurance schemes can extend existing or modified benefits to previously excluded groups, on either a compulsory or a voluntary basis. The inclusion of these groups may also enhance the schemes' effectiveness through improved governance and design.
- Special social insurance schemes can be set up for excluded groups.
- Universal benefits covering the whole target population without any condition or income test (for instance, those over a certain age) can be implemented.

– Social assistance programmes targeting specific vulnerable groups can also be implemented: waivers, social pensions/cash benefits, conditional cash transfers (for instance on school attendance).
– A complementary option is to encourage and support the development of microinsurance and innovative decentralized social security schemes to provide social protection through communities, social partners[4] or other civil society organizations.

3 What is microinsurance?

As described in Chapter 1.1, a microinsurance scheme may be an organization, like a mutual benefit society. It could also be a set of institutions working together, such as insurers that collaborate with microfinance institutions to provide insurance to the poor. Or it could be an insurance product provided by an organization that conducts other activities, like an agricultural cooperative that also provides insurance to its members.

Microinsurance schemes are often initiated by civil society organizations. Increasingly, these organizations cooperate with formal social protection schemes (e.g. insurance companies, social security schemes), public institutions (e.g. departments of health, labour and social affairs), service providers (e.g. healthcare providers, third party administrators (TPAs)). Sometimes even municipalities or local authorities are involved in offering microinsurance.

For a scheme to be of interest in the context of social protection, some of its beneficiaries should be excluded from formal protection schemes, in particular informal-economy and rural workers and their families. A microinsurance scheme differs from programmes that provide statutory social protection to formal workers. Membership is not compulsory (but can be automatic). The members contribute, at least partially, the necessary premiums to pay for the benefits. Since their capacity to contribute is often low, the coverage provided by these schemes is – in the absence of subsidies – usually limited, with a small number of risks covered and low levels of benefits.

As discussed in the previous chapter, workers in the informal economy and their families typically request coverage for illness and death; the demand for protection against other risks is less widespread, although it can be significant in certain markets (e.g. the demand for livestock and crop coverage in rural areas). In terms of availability, not all microinsurance products are present in all countries. Some products may be well-established in one

4 The ILO is a unique forum for governments to interact with employers' and workers' organizations, otherwise known as social partners. In the ILO's tripartite governance structure, employers' and workers' organizations have an equal voice with governments in shaping its policies and programmes.

region, but almost non-existent in another. For example, life microinsurance is seldom found in western Africa, whereas it is relatively developed in some Asian countries.

According to inventories of microinsurance schemes conducted in 2003/2004 in 11 African countries, India, Bangladesh, Nepal and the Philippines (ILO/STEP, 2003/2004):

- health microinsurance is predominant in Africa (100 per cent of investigated schemes) and the Philippines (70 per cent of the schemes provide health insurance); it ranks second in India (56 per cent of schemes) and Nepal (52 per cent), and is less important in Bangladesh (39 per cent);
- life microinsurance is most common in Bangladesh (72 per cent of investigated schemes provide life insurance), the Philippines (66 per cent) and India (60 per cent); it is less available in Nepal (38 per cent); and
- examples of crop microinsurance were found only in India (two schemes in 2004); pension schemes were only seen in India (4 per cent of investigated schemes) and the Philippines (24 per cent).

4 Potential and limitation of microinsurance as a social protection mechanism

Not all microinsurance plays a role in extending social protection. Some products – such as asset, livestock and housing microinsurance and credit-linked insurance that only covers the outstanding loan balance – though certainly beneficial, do not provide social protection coverage in the strict sense. In contrast, other products, such as health, life, old-age pensions and disability covers address the nine contingencies specified in ILO's Social Security Convention (No. 102) and therefore play a role in the extension of social protection.

4.1 Positive contribution of microinsurance in the extension of social protection

Where governments have limited financial and institutional capacity, microinsurance schemes may raise supplementary resources (finance, human resources, etc.) which benefit the social protection sector as a whole. More specifically, health microinsurance schemes help to improve access to healthcare by lowering the financial barriers that delay or impede access. In some cases, the quality of care is even improved, for example when the schemes sign agreements with healthcare providers on the quality of delivery. Con-

tracting with healthcare providers also increases transparency in billing practices and the way the health sector is managed.

Microinsurance also has several positive effects on the participation of civil society and the empowerment of socio-occupational groups including women. For example, since many schemes are set up and operated by women's associations, they may strengthen women's capacity to meet their health needs including those linked with their reproductive role.

Moreover, microinsurance as a mechanism to extend social protection has the following comparative advantages over classical social security schemes:

1. Microinsurance can reach groups excluded from statutory social insurance, such as workers in the informal economy and rural workers.
2. The transaction costs necessary to reach these populations may be reduced, since microinsurance schemes are often operated by decentralized civil society organizations, often relying on voluntary self management, that are implemented in the vicinity of the target population.
3. Microinsurance benefits are often designed in partnership with the target population. This participation is highest in mutual benefit associations where the benefit package is voted on by the general assembly. In other types of schemes, the target groups are usually consulted, for instance through household surveys. As a result, microinsurance often responds to the target population's needs and ability to pay.
4. Community-based schemes usually experience fewer problems with fraud and abuse than centralized social protection systems since members often know each other, belong to the same community and share the same interests. However, community-based schemes can have difficulty collecting regular contributions, resulting in retention problems and sustainability challenges. Some schemes manage this issue of low renewals through group insurance contracts with organized occupational groups (such as cooperatives).

The development of microinsurance is ongoing, with a proliferation of new schemes, especially in India. For example, ILO/STEP (2004) found 60 microinsurance schemes covering 5.2 million people. The inventory is being updated; the current (early 2006) number of schemes stands at 71 covering more than 6.8 million people in India and 240 microinsurance schemes covering 25 million people in 8 countries of Asia. This suggests that these schemes respond to a real demand and that they manage to solve a certain number of issues, at least at the local level.

4.2 Current limitations of microinsurance as a mechanism of extension of social protection

Despite these apparent advantages, certain characteristics of microinsurance schemes limit their contribution to the extension of social protection:

1. Although microinsurance is becoming more common, many persons excluded from legal social protection schemes are still not covered by microinsurance either. In fact, many of these schemes (particularly in Africa) have great difficulty extending their geographic or socio-occupational outreach and increasing their membership.
2. Many microinsurance schemes have poor viability and sustainability. These two points are linked (particularly in Africa) with poor management skills (not enough financial resources to employ professional staff) and inadequate information systems, which makes it difficult to monitor the scheme's operations.
3. Members' ability to pay is most often very low, which leads also to limited benefits in the absence of subsidies.
4. Most schemes do not take over the functions that are usually fulfilled by statutory social security schemes – such as redistribution between richer and poorer segments of the population – because contributions are often based on a flat rate. In addition, few schemes reach the poorest segments of the excluded groups who cannot contribute.
5. In many countries, the legislative framework and regulations are not adapted to these schemes and do not facilitate their replication and expansion.
6. Microinsurance schemes are usually self-governing organizations. They may pursue objectives that are not in line with government's strategy of social protection and their promoters may be unwilling to participate in national systems of social protection, as this could threaten the schemes' autonomy.

5 How can microinsurance be used to extend social protection?

An increasing number of states consider microinsurance as a tool for the extension of social protection, and include this mechanism in their extension strategies. In several countries, microinsurance schemes are already part of the process of implementing progressively more coherent and integrated social protection systems:

- In India, the prescribed use of the partner-agent model (see Chapter 5.2) increases the acceptance of insurance by the target groups;
- In Senegal, microinsurance schemes are mentioned in the national social protection strategy as a key mechanism to extend social protection;
- In Rwanda and Ghana, the State implements nationwide social protection schemes in health that are built on district- and community-based mutual organizations.
- In Colombia, the government provides subsidies that enable the poor to be purchasers of health insurance, which even stimulates competition to serve the low-income market by microinsurance providers and others *(Box 11)*.

Box 11

The extension of social protection through microinsurance in Colombia

As a part of the reform of the healthcare system in Colombia in 1993, a special scheme (Régimen Subsidiado de Salud) was introduced to finance healthcare for the poor and vulnerable groups (including their families) who are unable to pay contributions to the general insurance scheme.

The funds are raised through a solidarity contribution collected under the contributory social insurance scheme and various state subsidies. They are then channelled to several institutions, including 8 mutual benefit associations federated in a national apex organization Gestarsalud, which now covers 60 per cent of the market, "cajas de compensación" (20 per cent of the market), and several private commercial insurance companies that also cover 20 per cent of the market. Today this successful subsidized scheme covers 18.5 million people.

Source: Adapted from Pérez, 1999.

There are three ways to overcome the limitations mentioned above. First, further development of microinsurance is required to increase the population covered, enhance the benefits package and strengthen the capacities of the schemes. Second, linkages need to be developed with other players and institutions. Third, microinsurance needs to be further integrated into coherent and equitable social protection systems.

5.1 The further development of microinsurance

The further development of microinsurance has implications for various actors, including the promoters and operators of the schemes, as well as the state.

For microinsurance promoters and operators, this further development may mean altering the way the schemes currently operate. Management must become more professional to enable the schemes to deal with the increasing complexity of meeting the needs of the target group. One way of doing that is to outsource some management functions to specialized organizations. It may also mean setting up new schemes targeting the members of large organizations such as trade unions, cooperatives and occupational associations. Larger schemes are in a position to provide more comprehensive coverage, particularly against major risks like hospitalization, and they are often more sustainable as they can more easily build up financial reserves.

As described in Chapter 5.3, the state may also support the development of microinsurance through promotion and the sensitization of public opinion (particularly the target population). Other government measures might include:

- building the capacity of microinsurance schemes through improved management and monitoring systems,
- strengthening the viability and the financial capacity of the schemes, for example through reinsurance or guarantee funds,
- supporting structures like second-tier associations or networks that provide technical support and training to microinsurance schemes,
- facilitating the exchange of information between actors to make sure that successful experiences can be replicated with other groups or in different geographic areas,
- formulating recommendations on design: benefits package, affiliation, administration, methods of payment to healthcare providers and
- establishing structures to produce information (statistics, indicators) that can be used by these schemes to price their products more accurately.

5.2 The development of linkages

A key strategy to strengthen microinsurance schemes and compensate for some of their weaknesses is to link them to other organizations, institutions or systems. Table 6 provides a few examples, classified according to the types of mechanisms used and the possible partners.

Table 6

Typology of microinsurance linkages

Mechanisms	*Actors/partners*
– Subsidies (local, national, international) – Contracting with healthcare providers – Outsourcing management functions – Technical advice – Financial consolidation (reinsurance, guarantee funds) – Distribution of insurance products – Distribution of public goods (immunization, HIV/AIDS treatments and testing, social assistance) – Bargaining – Exchange of information, practices – Regulation, control	– Other microinsurance schemes, federations of schemes – Civil society organizations, mutuals, MFIs, trade unions, cooperatives, associations, etc. – Service providers, e.g. healthcare, TPAs – Private sector, pharmaceutical industry – Central and local governments – Public health programmes – Social assistance programmes, cash transfers – Social security schemes, private or public insurers – International cooperation

The sharing of functions or responsibilities according to each party's core competences may create complementarities, economies of scale and make the schemes more efficient. Examples of linkages include: Yeshasvini in India outsources management functions to a TPA *(see Chapter 4.6)*; formal insurance companies in many countries distribute products through community organizations *(see Chapter 4.2)*; the creation of economies of scale and bargaining power through the grouping of microinsurance schemes, as in the case of emerging African federations *(see Chapter 4.3)*; and channelling subsidies through mutual benefit associations in Colombia *(Box 11)*.

Functional linkages may also be established with other components of social protection to improve the coherence of the national system of social protection. Examples of such linkages include channelling social services to eligible members and distributing social insurance *(Box 12)*.

Box 12

Linkages in the Philippines

The Philippines Health Insurance Corporation, or PhilHealth, has a mandate to achieve universal coverage by 2012. One of the paramount challenges is to provide health insurance coverage to workers in the informal economy, which is estimated at 19.6 to 21.7 million workers or between 70 and 78 per cent of the employed population.

In response to this challenge, PhilHealth approved a resolution in 2003 to allow partnerships with organized groups on a pilot basis. The partnership, called PhilHealth Organized Group Interface (POGI), is seen as an innovative approach to reach out to workers in the informal economy through

cooperatives. The initiative is being tested with eleven cooperatives that conduct marketing and collect premiums for PhilHealth.

Source: Adapted from GTZ-ILO-WHO, 2005.

A critical linkage to achieving social protection objectives is with healthcare providers. The decentralization of the healthcare sector may facilitate contractual arrangements between microinsurance schemes and healthcare providers at the local level. To ensure that these relationships are mutually beneficial and effective, however, it may be necessary for the government to intervene *(Box 13)*.

Box 13

Developing balanced linkages in Senegal

In Senegal, most mutual health organizations sign contractual agreements with healthcare providers. However, the relationship is often unbalanced and the mutual has no real means of compelling the healthcare provider to respect its commitments.

To face this problem, the Ministry of Health recognized the need to design a national contracting policy and framework that gives guidelines and concrete tools to facilitate the contracting process, including stages in the design of an agreement, minimum content of an agreement, commitments of both parties (including financial aspects, invoicing and payment methods), monitoring tools and procedures, and the State's role. A working group was created in 2006 to design a first draft of this framework that will then be presented to the relevant stakeholders for their feedback.

As illustrated in Box 11, mechanisms to redistribute subsidies can help microinsurance schemes provide a minimum package of social protection to poorer households or individuals with low contributive capacity or high social risks (e.g. the elderly, the chronically ill, certain occupational groups). Such mechanisms provide an equitable access to social protection independently of individuals' characteristics and financial capacity. Beside their redistribution role, these subsidies also make the beneficiary microinsurance schemes more attractive, which helps bolster their membership. Since redistribution at a national level may not be sufficient for poor countries, it is also useful to consider international redistribution *(Box 14)*.

Box 14

The Global Social Trust

The mission of the Global Social Trust is to systematically reduce poverty in developing countries through a partnership that invests in and sponsors the development of sustainable national social protection schemes for people and

groups that have been excluded from the economic benefits of development. The basic idea is to request people in richer countries to contribute on a voluntary basis a modest monthly amount (say 0.2 per cent of their monthly income) to a Global Social Trust that will be organized in the form of a global network of national trusts supported by the ILO. The Trust will invest these resources to build up basic social protection schemes in developing countries and sponsor concrete benefits for a defined period until the schemes become self-supporting. For more information, see: http://www.ilo.org/public/english/protection/socfas/research/global/global.htm

5.3 Integration into coherent and equitable social protection systems

Providing social security to citizens remains a central obligation of society. Through legislation and regulations, governments are responsible for ensuring that the public has access to a certain quality of services. This does not mean that all social security schemes have to be operated by public or semi-public institutions. Governments can delegate their responsibility to organizations in the public, private, cooperative and non-profit sectors.

What is needed, however, is a clear legal definition of the role of the different players in the provision of social security. These roles should be complementary, while achieving the highest possible level of protection and coverage. For example, a social security development plan would define the scope and coverage of services through government agencies, social insurance, private insurers, employers and microinsurance schemes. In this context, governments and social partners should explicitly recognize microinsurance as a social protection tool and integrate it into national strategies of social protection, health development and poverty reduction (e.g. PRSPs in Senegal). The role of health microinsurance in an overall health financing policy coordinated by the State should be recognized as well. The overall aim of such a policy is universal access to healthcare based on pluralistic financing structures *(Box 15)*.

Box 15

Cambodia's Master Plan

In Cambodia, the government recognizes the potential of social health insurance as a major healthcare financing method. To reach universal health coverage, Cambodia's Master Plan for Social Health Insurance recommends a parallel and pluralistic approach which comprises: (1) compulsory social health insurance through a social security framework for public and private sector workers and their dependants, (2) voluntary insurance through the development of community-based health insurance schemes and (3) social assistance

through the use of equity funds and later government funds to purchase health insurance for non-economically active and indigent populations.

Source: Adapted from WHO Cambodia, 2003.

The design and adoption of appropriate legal frameworks is a key step towards this integration. Such a framework may specify the role of microinsurance in the social protection system and introduce a set of rules and institutions for the supervision of microinsurance schemes. Legislative frameworks can contribute to the development of these schemes, although frameworks with high financial requirements or intensive supervision from the public authorities may restrain their development. To strike an appropriate balance, ILO/STEP is supporting the construction of a regional framework in eight UEMOA *(Union économique et monétaire d'Afrique de l'Ouest)* countries to design and implement legislation to regulate mutual benefit organizations and support their development.

For microinsurance promoters, the integration into social protection systems has various implications. The benefits package that they provide should include coverage against one or more of the contingencies listed in Convention 102. Moreover, when a minimum guaranteed package of social protection has been defined by the legislation, these schemes should provide this coverage to all their members. Microinsurance schemes' internal regulations should abide by the principles of equity defined by legislation (if any). Rules such as the exclusion of members over a certain age or calculation of premiums based on individuals' risks may not be in line with such principles. If microinsurance schemes receive public financial support, they should be accountable for the efficient use of these public funds. This implies that strict rules of management and accounting be enforced. Microinsurance schemes should also agree that their financial statements be supervised by a public or independent regulatory body.

More generally, it is important that promoters and operators of microinsurance be involved – either directly or indirectly through federations representing their interests – in national consultations and negotiations with the state and other stakeholders in the design and implementation of national social protection strategies. Such integration needs a climate of trust and confidence between operators of schemes, networks of schemes, other civil society organizations representing the populations covered by these schemes (trade unions, cooperatives, etc.) and the government *(Box 16)*.

Box 16

An integrated approach to social protection in Senegal

In Senegal, many actors have contributed to accelerate the process of extending social protection, including the State, local governments, social partners and other civil society organizations, donors and healthcare providers. Several events have been significant:

- In 2003, the law on mutual health organizations was adopted; a national framework on the development of MHOs was created, as was the national committee on social dialogue.
- In 2004, the global campaign on social security and coverage for all was launched in Senegal. The trade union of transport operators included social protection issues in its platform. In addition, a law was adopted to design and implement a social protection scheme for rural workers *(Loi d'Orientation Agro-Sylvo Pastorale)*.

These events have been integrated in the logical framework of the national strategy for the extension of social protection and risk management (SNPS/GR) formulated in 2005 with the active participation of a large number of players. This strategy aims at extending social protection from 20 to 50 per cent of the population by 2015 through new schemes designed to respond better to the priority needs of informal-economy workers.

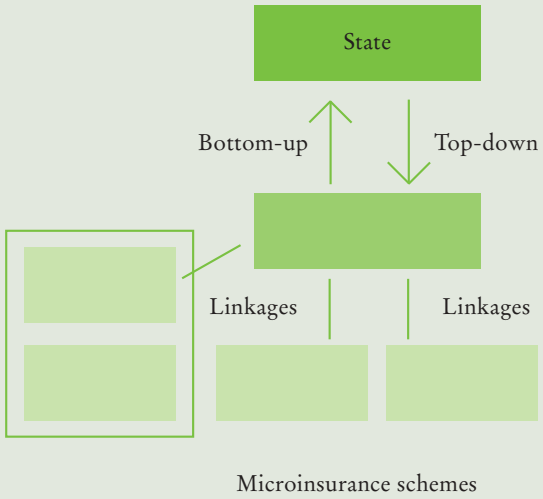
These events and the national strategy formulation led in 2006 to feasibility studies to design and establish two nationwide social protection schemes, one for transport operators and their families (target population of 400,000 people) and the other for rural workers and their families (target population of 5 million people).

6 Conclusion

Microinsurance is one instrument which can be used to extend social protection to the excluded. It is particularly relevant in situations where governments lack the resources and capacity to provide social protection. Even in situations where the resources are available, if governments support microinsurance as a social protection mechanism, like in Colombia, it may be a more efficient means of social protection than services provided entirely by the government. For microinsurance to achieve its potential, and overcome its limitations, it requires a dynamic, three-pronged approach, as illustrated in Figure 5:

- **Bottom-up initiatives:** To stimulate the grassroots development of microinsurance, it is necessary to sensitize the general public, policymakers, donors and development agencies, as well as social partners and other social protection actors, about how microinsurance works and its potential contribution to social protection.
- **The development of linkages** with government interventions, other microinsurance schemes, healthcare and other service providers, social security institutions, social assistance programmes, etc. can strengthen the sustainability of the schemes as well as enhance their effectiveness.
- **Top-down efforts:** To fulfil its social protection potential, microinsurance must be seen by policymakers and other stakeholders within the broader context of coherent national social protection systems or strategies.

Figure 5 **A dynamic approach to extending social protection through microinsurance**



As an independent risk-management arrangement, microinsurance is not sufficient to protect poor people against risk. An integrated strategy of social protection should be conceived in collaboration with the government, the private sector, health professionals, social partners and other civil society organizations. Microinsurance can be most successful if it complements other risk-management instruments on the basis of a comprehensive risk assessment.

Although the operations of microinsurance schemes are largely the same regardless of their objectives, microinsurance schemes in the context of social protection should be assessed and monitored differently from microinsur-

ance schemes for assets, livestock or housing, for example. The social protection schemes have to be inclusive of high-risk or destitute members, and ideally access public subsidies to compensate for the higher claims or lower contributions. If they access public subsidies, they also have to be accountable for them, ensuring that those funds are used efficiently and for the intended purposes.

The decision to implement or support microinsurance schemes is not only driven by a risk analysis, but also by political considerations: priority contingencies to cover, populations to be targeted, the relevance of this mechanism as compared to others, and the possibility to link it to other mechanisms and other social protection components. The objective is to improve efficiency, increase coverage and progressively create more coherent and equitable systems of social protection.