5 The role of other stakeholders

5.1 The role of donors

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Poor people in developing countries enjoy limited protection against the numerous perils of life. Losers in the "lottery of geography", they live in countries with large informal economies and weak institutions. Governments strapped for cash and with inefficient systems are often unable to provide adequate social protection. The private and formal sectors of these countries are typically tiny and closed to the majority of citizens. Insurance companies are no exception, and they often do not appreciate the market opportunity at the bottom of the pyramid. Exclusion from both social protection and formal insurance is thus the norm.

In this context, what is the role of international development aid? This is the central question the chapter addresses. Building on the aid effectiveness initiative of the Consultative Group to Assist the Poorest (CGAP), this chapter seeks to understand donor systems and to examine how they can hinder or foster the application of good practices. It also draws from the *Preliminary donor guidelines for supporting microinsurance* to suggest specific strategies donors may employ to support the expansion of microinsurance services.[1]

Microinsurance is growing in popularity among donors, perhaps because it addresses the core vulnerabilities of the poor. The objectives of microinsurance – helping low-income people manage risks and stopping the vicious cycle of poverty and vulnerability – respond to many donor priorities. Both faces of Janus described in Chapter 1.1 are highly relevant to donors. Whether from a social protection point of view or within the context of a private sector/financial sector approach (or a combination of both), donors are interested in the contributions of insurance to the Millennium Development Goals. However, this donor enthusiasm is cause for both caution and optimism.

1 This document was prepared by the CGAP Working Group on Microinsurance (2003).

Donors[2] are well-placed to step in and address both the public- and private-sector market failures. The intelligent use of subsidies can serve as a catalyst to spark the interest of private actors in a new and unfamiliar market segment, provide much-needed investments in social infrastructure such as local healthcare centres, help build the capacity of local players, and promote policy changes to remove barriers to access.

1 An analytical framework

Microinsurance is multi-faceted and requires work at all levels of the market *(Figure 34)*. Starting with the clients, what is key is (1) the capacity of retail providers to offer insurance services appropriate for low-income persons ("micro" level), (2) the supporting infrastructure and second-tier support for micro-level providers to reduce costs, improve market information and transparency, and reach scale ("meso" level) and (3) the policy environment ("macro" level).

Figure 34 **An analytical framework for donor support for microinsurance**

2 For the purpose of this chapter, donors include bi- and multi-lateral agencies, regional development banks, foundations, and socially responsible investors. Much of the discussion will also be applicable to other organizations that fund microinsurance or design and manage microinsurance programmes on behalf of donors, such as international non-governmental organizations (NGOs), consultants and international networks.

Acquiring a thorough understanding of the market at all three levels is an important first step for any donor considering a microinsurance intervention. The country context matters, as does the state of market development. To enable microinsurance to flourish, it is essential to understand clients' needs and to promote insurance literacy. A range of insurance providers (commercial insurance companies, cooperatives, mutuals, etc.) and delivery mechanisms are needed to serve people without access where they live and work. For these retail providers to be strong and transparent, they require access to a host of services from reinsurance and training to national information clearinghouses. Finally, the overall policy and regulatory environment is important for the protection of consumers, the reduction of barriers to entry and the promotion of competition.

2 Donor requirements to effectively support microinsurance

Without the right knowledge and resources, overzealous donors may design ineffective programmes that never reach significant scale and waste money. Worse, failed microinsurance schemes can breed distrust among clients who are often wary of insurance services to start with, and among insurance providers sceptical of this new market segment. Well-directed donor interventions, however, can create new focus, know-how, innovations and powerful demonstration effects in expanding poor people's access to insurance services.

Much has been learned about what it takes for donors to manage effective programmes though CGAP's work on the effectiveness of aid.[3] Depicted as the Aid Effectiveness Star *(Figure 35)*, five core elements provide a useful framework to discuss the donor prerequisites needed to successfully support insurance services for the poor. While all elements of the Aid Effectiveness Star are important, not all donors can be equally strong across the five. Rather, donors should use the five elements to assess their internal systems and identify areas for improvement. They can use this analysis to determine 1) *whether* to intervene at all in microinsurance and 2) *how* to intervene using their comparative advantage.

3 For example, see Cook et al., 2005.

Figure 35 **The Aid Effectiveness Star**

2.1 Strategic clarity

Does the donor possess a clear vision and understanding of what microinsurance is, how it contributes to the agency's overall development goals, and what it takes for the agency to support microinsurance effectively?

Donors' interest in microinsurance could stem from various entry points, including social protection, health, agriculture, risk management or financial services. So it is not surprising that microinsurance programmes can originate from several departments within the same donor agency. At the ILO, for example, the Social Finance Programme looks at the financial sector angle, while the STEP programme considers the social protection perspective. Few development agencies have dedicated insurance departments or units.

Opportunities for sharing information and making a real impact may be lost due to the scattered presence of microinsurance in donor agencies. Donor staff often function in silos. Colleagues working on the same issue, though looking at it through different "lenses", may not speak to each other or even know of each other's activities.

There are few stand-alone microinsurance projects in donor agencies' portfolios, but rather insurance is usually included as a component of larger projects. As such, microinsurance might not get the specialized attention it requires. Rarely does one part of the organization have mandatory vetting or quality-control authority.

Strategic clarity also affects how donors interact with key stakeholders on the ground – the government, private sector and civil society. A strong penchant for one face of Janus over another (e.g. social protection versus private sector) will influence who donors engage with and the content of negotiations. Different policy issues will emerge as well. From the social protection face of Janus, a core question for donors may be "how far does promoting microinsurance let governments off the hook for providing social security?" With the private sector face, donors might ask "how appropriate is it to transfer donor subsidies to private sector companies?"

Donors do not view the subject through neutral lenses. Strategic clarity affects how objectives are set, the expertise recruited, and the type of monitoring implemented. Decisions that appear operational in nature may actually have major strategic implications. For example, opting for group-based, as opposed to individual, policies generally results in far more inclusive and cost-effective insurance. Whatever the entry point, clients should be at the centre of all decisions made. In particular, donors should consider clients' needs for risk-management strategies broadly – insurance might not always be the best response. Other services such as savings can be quite effective in helping clients manage risk.

2.2 Strong staff capacity

Are there sufficient staff in the donor agency with insurance expertise relative to the size of the insurance portfolio? Even when the donor relies on outsourced expertise, a minimum level of "insurance literacy" is needed internally.

Involvement in this field requires a basic understanding of insurance principles and practices. In addition, depending on the type and level of intervention, donors may require specific technical expertise such as insurance management and accounting, actuarial sciences, underwriting and claims adjustment, or knowledge of insurance regulation.

However, insurance expertise is scarce among most donor agencies, with the lack of microinsurance knowledge even more acute. This problem is compounded by an overall trend for donor staff to become generalists. The lack of specialization of staff has serious consequences for the quality of programmes. While it is not realistic to expect all agencies to have in-house microinsurance expertise, staff managing projects that include insurance should have a minimum level of "insurance literacy" to outsource intelligently and know the right questions to ask.

Unfortunately, in the case of microinsurance, there is even a dearth of readily available expertise available for contracting. Several donor agencies rely on the same, limited number of microinsurance consultants. Donor networks in some of the specialized areas required for insurance, for example actuarial science and underwriting, are small or non-existent.

Besides having some in-house expertise in insurance, effective donors should possess local market knowledge. Decentralized donors with staff based in countries/regions may have an advantage in this regard. Without an understanding of the local environment, donors cannot properly judge whether implementing partners are assessing the priority needs of the target population, the types of risks they face, existing risk-management mechanisms and the additional protection they need.

2.3 Appropriate instruments

Does the donor agency have instruments appropriate for innovative pilot programmes? Can the donor deploy small amounts of funding flexibly, with a long-term perspective? Can the donor work directly with the private sector?

The range of donor instruments available includes technical assistance, grants, loans, equity, guarantees and policy support. Since microinsurance is still in an experimental stage, donors should adopt a patient and cautious approach, providing small amounts of funding, perhaps for longer periods of time. Asking for co-funding from partners is one way to test real, long-term commitment. From the beginning, plans for reaching sustainability should be discussed.

Insurance is a highly specialized activity. Thus, whenever possible, donors should seek to work with existing institutions that already have this expertise, such as insurance companies or perhaps health mutuals *(mutuelles de santé)*. Working with formal insurers raises the question of the appropriateness of providing public subsidies to privately-owned companies. Most development agencies enthusiastically support private sector development and public-private partnerships. Yet, many donor staff feel uncomfortable about granting scarce donor funds to private players. Furthermore, much remains to be learned about how to structure this support and how to plan for exit *(see Box 86)*.

Box 86

Unleashing the catalytic role of the private sector with public subsidy[4]

Donor subsidy, when well-targeted and time-bound, can incite the private sector to help address gaps and overcome market failures. The following are some principles for the provision of subsidies to the private sector:

- Donors should only fund activities that are accepted as being pro-poor and of high quality, and thus able to yield measurable social returns
- Donor funding should enable or accelerate a process that otherwise either would not have taken place or would have taken much more time to occur
- Donors should be careful not to subsidize something that the private sector would be willing to do on its own, and not to unfairly subsidize the competition of a private-sector initiative
- Private companies should provide some of their own funds (co-funding), and the margins/profits realized from the activity should not be excessive
- Donors should identify partners where the highest possible leverage effect is likely
- The goals of the activities funded should be achieved in a commercially viable manner, i.e. the private entity must recognize a viable business case

In markets where private-sector insurers indicate an interest in the low-income market (e.g. India, South Africa), donors can play a catalytic role in drawing them in and linking them to institutions able to fulfil front office functions. In such cases, money is less important than knowledge, tools and networking.

However, the reality of certain countries is that formal insurers are years away from entering the low-income market. In these countries, various types of non-specialized institutions offer insurance, ranging from credit unions to health mutuals. Donor funding may be usefully deployed in this approach, especially technical assistance and grants. Technical assistance can help improve market research, product development, training and client education. Grants may be used to defray the purchase of fixed assets or to cover operating losses. To avoid creating disincentives for good management and efficiency, donors should only cover operating losses in the first few years when the client base is small and premiums do not yet fully cover costs.

4 This box is based on an interview with Jonathon Ridley of Enterplan, who is involved in managing DFID's Financial Deepening Challenge Fund, which has provided grants to private-sector firms, including insurance companies. See DFID/FSCF, 2004.

Donors can also selectively deploy loans and guarantees to support microinsurance. Loans to governments from multilateral development agencies are often used in social protection programmes. Guarantees are mostly appropriate to help link reinsurers to microinsurers *(see Box 87)*. Partial guarantee funds where the reinsurer takes a significant amount of the risk, but has some coverage from the donor funds, can help introduce reinsurers to this new market. The key to successful guarantees is setting the incentives in such a way that insurers manage as if their own money were at risk, and ensuring diminishing benefits over time. Donors should obtain expert assistance to structure the guarantee funds appropriately and should monitor their impact and cost-effectiveness.

Box 87

Providing support through donor guarantees

A DFID guarantee was critical during the start-up phase of the Nsambya Health Insurance Plan (NHHP), now known as Microcare. The NHHP had no reserves, nor could it access reinsurance (normally the next line of defence for insurers after reserves) because it was not yet a regulated insurer. DFID's subsidies enabled NHHP to test methodologies for serving the poor, such as delivering health insurance to low-income communities by tapping into the clientele of a microfinance institution. To limit its own risk, DFID reserved the right to monitor the pricing and achievements of the objectives of NHHP's business plan.

Source: Adapted from Dror and Preker, 2002.

Certain costs, such as claims costs, should rarely be covered by donors. Clients should face the true costs of well-managed insurance from the beginning. An exception might be social protection schemes that have access to significant sources of stable funding (from governments, for example) and can subsidize premiums for very poor or high-risk persons over the long-term. Even then, the risk of drop-outs and/or financial collapse is high when the subsidy is withdrawn.

For now, the bulk of donor support is appropriately targeted at the retail level. Over time, investments at the market infrastructure and policy levels will become more important as donors seek to help foster a coherent overall system for increasing poor people's access to insurance services. Typically, instruments best suited for work at the market infrastructure and policy levels include grants, technical assistance and policy support.

2.4 Accountability for results

Is there transparency in the donor agency for all projects that include microinsurance? Does the donor monitor performance of microinsurance programmes, and take action based on results?

Improving the accountability of public subsidy is of paramount importance. Doing so requires more than ex-post evaluations. Incentives for accountability should be introduced at all stages of the project cycle.

Since microinsurance often emanates from multiple departments within the same agency, it is important to have up-front clarity about the most desired outcomes. What is good microinsurance? Is it achieving financial sustainability and attaining social objectives, e.g. meeting clients' priority needs, improving healthcare quality or advocating better labour codes? Donors should reach agreement on the common expectations of performance, whichever face of Janus they are pursuing.

Agencies also have to decide whether they wish to have a single quality assurance focal point to review all projects with microinsurance components. Ensuring that adequate due diligence is carried out (whether by the donor, outsourced experts or the implementing partner) is also part of improving accountability up front.

Exit strategies should be discussed at an early stage as well. Exit is only possible when sustainable market capacities are built. If this does not happen, donors will find it extremely difficult to withdraw support without jeopardizing poor people's access to insurance. For example, the Rabobank Group and its reinsurance company, Interpolis N.V., are having difficulty exiting from Yasiru in Sri Lanka, a microinsurance scheme they have been supporting since 2000. If Rabobank exits, Yasiru will either have to dramatically reduce its costs or increase its annual premiums by about 60 per cent to fully compensate for the reduced financial support.

To ensure the best possible implementation, donors should select outsourced expertise carefully and conduct an appraisal of potential partners. Contracts with both technical service providers (for example, if a consultant is hired to help manage the project) and the microinsurance provider should be performance-based to tie continued support to the achievement of key milestones. For example, disbursements could depend on meeting minimum performance thresholds such as the number of people insured and a benchmark expense ratio, complemented by a satisfactory review by an actuary.

A mix of on- and off-site monitoring of microinsurance projects is vital to identify problems early on, ensure proper utilization of funds and document lessons learned. Donors should request quarterly reports from their microinsurance projects. Besides key performance indicators, the quarterly reports should include qualitative information from management with progress updates on the business plan, budgets, achievements, problems encountered, trends and any management issue such as major human resource changes.[5] Monitoring by an actuary at least annually is also highly advisable. The actuarial review should include a comprehensive appraisal of performance, including the adequacy of premium rates and claim reserves.

As with savings, the important responsibility of protecting poor people's money cannot be taken lightly. The challenge for donors is to balance their role as risk takers (i.e. funding innovations that may or may not succeed) with that of being responsible funders. Failed microinsurance programmes can have negative long-term consequences for clients, actual and future providers, donors and governments.

2.5 Relevant knowledge management

To what extent are donor agencies learning from their own and others' experiences, and feeding that learning back into new programme design? Are donors making use of the increasing volume of microinsurance literature to learn about a variety of models, possible linkages and partnerships?

The complexity and multi-faceted objectives of microinsurance require that donors share information and coordinate at several levels. Donors should coordinate with (i) private sector insurers, (ii) relevant government social protection agencies to synchronize governmental and microinsurance efforts and (iii) other funders to establish common strategies and avoid duplications. The GTZ-initiated donor consortium to support VimoSEWA is a good example of a joint effort to provide donor funding in a coherent manner. The consortium includes CGAP, the Ford Foundation and the ILO (for research support). All agencies discuss continuously and co-ordinate their funding to support VimoSEWA's business plan.

Though a lot has been written on microinsurance recently and some training courses exist for practitioners, there is little training targeted specifically at donor staff. Especially since the topic is relatively new, donor staff need various fora to exchange experiences and discuss the reasons for the failure and success of microinsurance programmes.

Donors can also identify partnerships with other donors whose "star" complements their own. For example, a development agency with strong

5 Standards for monitoring are still under development and appropriate benchmarks are also in their formative stages *(see Chapter 3.10)*.

staff expertise could team up with a donor that has flexible grant-funding to pilot programmes. Donors with strong data management systems and insurance knowledge could help promote information clearinghouses.

The following section discusses in more detail the types of donor actions likely to deepen poor people's access to insurance services.

3 Types of donor support for microinsurance

Donors are not in the driver's seat in developing insurance services for poor people. The donor role is to serve as a catalyst, with governments, the private sector and civil society taking the lead. Nonetheless, donors can have great influence on how quickly and well – or poorly – microinsurance reaches scale. Donors should wait for the demand from stakeholders in countries, rather than actively promoting microinsurance.

The choice of intervention should be founded on a good understanding of all levels of the market, the state of market development, and the donor's own strengths. A range of possible donor interventions, starting with clients at the centre, is presented below. Not every donor can or should work on all these levels.

3.1 Clients

Microinsurance providers are the closest to actual and potential clients, and are best suited to understand client needs and provide client education. That said, donors have a role in commissioning research and creating tools. Whenever possible, donor-funded work in these areas should be public goods that multiple providers can use.

Client education on the benefits of insurance services is key to the success of microinsurance. The costs of designing appropriate materials for client education and training staff to provide these "non-insurance" services are not negligible. Ultimately, these costs should be factored into the marketing expenses of providers. However, donors can help by:

- investing in designing materials for client education, including bearing the cost of translating and adapting existing materials for specific contexts;
- offering training courses on client education;
- subsidizing the upfront development costs of client education for new microinsurance providers;
- ensuring that a strategy (and associated budgets) for client education is part of providers' business plans and

– including information on insurance in the growing number of financial literacy campaigns.

Too often, **client demand is assumed, misunderstood or over-simplified**. Donors can help improve understanding of client demand by:

– funding the development of user-friendly tools for conducting insurance market surveys;
– funding national market surveys to better understand the needs and risk-management mechanisms of low-income households (the demand side) and how the needs are currently addressed by public, private and informal organizations (the supply side); the FinScope surveys are a good example of this kind of donor support *(Box 88)*.

Box 88

FinScope surveys: Getting to know the market[6]

The FinMark Trust, which was started with a grant from DFID, has pioneered the use of specialized household surveys of financial services usage through its *FinScope* surveys in South Africa.

FinScope tracks the changing patterns of access to financial services across all the main product categories – transaction banking, savings, credit and insurance – in the formal and informal sectors. For example, the 2005 South Africa FinScope survey found that 34 per cent of people had some kind of insurance. Much of this coverage came from informal or semi-formal providers such as burial societies. The survey showed that “unaffordability” was the main barrier to funeral coverage. The survey also indicated that at least one third of the 53.5 per cent of un-banked South Africans have access to a cell phone and that those people who are aware of cell phone banking believe it will make the cost of financial services diminish.

The FinScope surveys are powerful tools for public and private sector decision-makers to think about how to reduce barriers to access and how to innovate to reach new market segments, including low-income and poor people. FinScope South Africa is now fully funded by the private sector, and is being replicated in other countries.

3.2 Micro level: Retail microinsurance providers

Retail providers and their distribution channels are the backbone of delivering insurance services to the poor. Building the capacity of institutions to provide appropriate, good-quality and affordable services to the low-income

6 For more on Finscope, please see www.finscope.co.za.

market segment is one the greatest challenges in increasing poor people's access to insurance services. However, the need for donor support should not always be assumed. For example, Delta Life in Bangladesh has never had any donor support. Though some question the quality and appropriateness of Delta's products, it is undeniably one of the oldest and largest microinsurers. Nonetheless, in many markets, for insurance to be widely available, donors have a role to play.

Donors should prioritize working with existing formal insurers to serve the poor whenever possible. They can also help build the capacity of grassroots organizations such as cooperatives. Donors should generally not push or encourage new microinsurance providers. In some areas, however, existing providers may not be interested in serving the poor and/or face legal and regulatory limitations in expanding their services. Effective donor responses can then range from helping to build a viable business case for formal insurers to working to improve the legal framework or cautiously exploring support for new providers.

Given the close association of microinsurance with microfinance, donors should be particularly careful not to encourage MFIs to bear the risk of providing insurance. Insurance is a specialized activity that requires specific competencies few MFIs have or can profitably develop. Instead, donors can help MFIs negotiate with formal insurers. Even through partnership models, some MFIs may not be solid enough to venture into insurance.

Capacity-building is needed in almost all cases, no matter what model or approach is chosen, including the partner-agent model. While formal insurance companies already possess insurance skills, they often need guidance to improve their marketing, distribution and claims systems to effectively serve low-income households.

Perhaps the most important donor contribution is to make **technical assistance** – and to a lesser degree, financial assistance – available to the retail providers at the micro level. Figure 36 outlines the areas in which technical assistance is needed to strengthen institutions. It also suggests the types of technical service providers available (since donors tend to fund technical assistance, not provide it directly) and the various mechanisms used to transfer knowledge and skills. The issue of technical assistance is explored in more detail in Chapter 5.5.

Figure 36 **The what, who and how of microinsurance technical assistance**

Areas of technical assistance (what?)

– Client education
– Market research
– Feasibility studies
– Product development/refinement
– Business planning
– Operations (procedures, manuals)
– Marketing

Technical service providers (who?)

– Independent consultants
– Private consulting firms
– Networks
– Associations
– Training institutes/Universities
– International NGOs
– Donor projects/staff
– Insurance companies (as part of corporate social responsibility or through foundations)

Delivery mechanisms (how?)

– On-site advisors
– Short-term consultants
– Management contract
– Training
– Study visits
– Tools
– Multi-donor funds

Building the capacity of providers starts with defining the skills needed, then designing the best package of services (for example, see Goodwin-Groen et al., 2005). Selecting the right technical service provider and delivery mechanism is crucial. Donors should focus on the technical service providers' track record and their staff with some basic knowledge of microinsurance. Especially if not using the partner-agent model, donors may need specific insurance skills in-house.

Capacity-building requires patience and time. Donors should make a long-term commitment, using performance-based contracts. Both parties should respect their engagements: for donors that means timely service and disbursements. If results are poor, donors should withdraw support.

Unfortunately, there do not appear to be sufficient, quality technical assistance providers and training institutes with microinsurance skills, which poses a real challenge for strengthening retail providers and building up donors' microinsurance portfolios quickly.

Donors can also provide *financial assistance*. The range of financial assistance, from purchasing fixed assets to providing guarantees and covering operating losses was described in the discussion on instruments. In general, donors should not capitalize new insurance entities, nor is it generally recommended that they subsidize premiums *(see Box 89)*.

Box 89

Lessons learnt the hard way: Illustrations from India

Yeshasvini Trust. The Government of Karnataka partially subsidized the premiums of Yeshasvini Trust. However, when the subsidies stopped, the premiums had to be doubled from Rs. 60 (US$1.35) to Rs. 120 (US$2.70) per adult, and the number of policyholders plummeted from 2.2 million to 1.45 million.

Karuna Trust. Initially, UNDP fully subsidized the premium for members below the poverty line and other disadvantaged groups. Many members were not aware they were insured. When the premium subsidy was removed two years later, about 70 per cent of the members wanted to drop out – they did not want to start paying for services that had previously been free and felt that the premium was too high. After a major client education and information campaign, half the clients ultimately renewed and paid for policies.

3.3 Meso level: Market infrastructure and public goods

Poor information on the target clientele, the limited number of specialized technical service providers, the lack of ready-made information systems, and the scarcity of reinsurance can all seriously constrain the expansion of insurance to poor clients.

Retail providers require a host of services and information to perform effectively, assess risks appropriately, reduce costs and become more transparent. As seen above, donors can contribute significantly to funding, brokering and even providing some of these services. Long-term access to these services, however, will require local and regional solutions that are usually private-sector led. Supporting the emergence of local or regional market infrastructure and public information goods is a fairly new area for donors. The range of areas that require donor subsidy at the meso level is quite varied and includes supporting market infrastructure like networks and training providers, promoting transparency and fostering knowledge management.

Supporting meso-level institutions/mechanisms

– **Networks/trade associations.** International networks can help strengthen microinsurance providers, as Opportunity International has done. Donors can make best use of their time, expertise and resources by channelling funding through well-managed networks. Donors can also work with insurance associations to sensitize them to the low-income market segment.

- **Information clearinghouses.** Typically, formal insurers have little if any information on the low-income market segment. Clearinghouses with information on the most important risks facing this market segment are sorely needed. Data on the cause and frequency of specific risks is essential to price products correctly and identify appropriate loss prevention programmes. Donors should work together to promote and fund the development of such clearinghouses at the national and regional level. Donors can also support clearinghouses with information on qualified technical assistance providers.
- **Training/technical assistance service providers.** Fostering the supply of private sector technical assistance and training providers is very challenging and best done by joint donor programmes. Donors can help build the capacity of local/regional providers through training of trainers (TOTs) programmes, materials development and business planning.

Promoting transparency

- **Management information systems (MIS)**. Homegrown information systems are expensive and time-consuming to develop. Donors can invest in building MIS to improve the quality and accuracy of information flows. More transparent reporting allows for better management and can attract partners such as reinsurers. Systems developed with donor funding should be open-source, to facilitate duplication and adaptation.
- **Performance indicators/standards**. Donors should share information on the performance indicators they currently use, including definitions for each. Those with the most technical expertise should lead a process to agree on the main menu of indicators required for the good management of insurance schemes – donor reporting should draw on those indicators, and not require long lists of indicators that are irrelevant to microinsurance managers.
- **Benchmarking**. Benchmarking microinsurers' performance across peer groups can assist managers in improving performance *(see Chapter 3.10)*. It is also useful for reinsurers and donors to better understand the performance of microinsurance. Benchmarking is only possible if donors insist on transparency and agreement is reached to share and pool data collected following the same standards.

Fostering knowledge management

- **Research on clients**. All microinsurers should include the costs of better understanding client demand in their operating expenses. However, punctual, major national surveys can be valuable to numerous providers, especially in markets where information is scarce and hard to collect.

- **Tool development**. As more donors and their outsourced expertise gain experience in microinsurance, they should fund the development of tools and guides that could be published on the web for the use of all. Tools that could be of great use include guides for conducting market research and feasibility studies.
- **Lessons learned and good-practice guidelines**. Capturing lessons learned from what works and what does not is useful for new entrants and struggling programmes. Donors should include knowledge-management components in their programmes and proactively record lessons learned.

3.4 Macro level: Supportive policy environment and advocacy

As described in the next two chapters, the policy and regulatory environment in some countries can be detrimental for microinsurance. A supportive environment for microinsurance, however, allows for the emergence of different types of providers. Only donors with the right technical skills (including staff in the field), good retail-level knowledge, strong influencing capacity and the trust of governments should engage at the macro level. Donors should proceed carefully in attempting to influence government policies, especially in countries where there is not much experience at the retail level.

- **Government advocacy**. Donors may be well-suited to undertake a range of advocacy efforts. Advocacy could include promoting better social security, enhancing ministries' capacity to improve healthcare, labour standards and so on, and reducing entry barriers for new players. Often, research is required to prepare strong evidence-based messages for government.
- **Regulatory frameworks and supervision**. While working at the retail level, donors sometimes encounter obstacles in regulatory systems. This retail experience can help them lobby more effectively for specific changes. For example, when the government of India was preparing microinsurance regulations, it posted a concept note on the Insurance Regulatory and Development Authority's (IRDA) website and many donor agencies, including GTZ and the ILO, submitted official comments on the paper.
- **Consumer protection**. Donors can promote greater transparency in premiums, the exact nature of cover, and the claims settlement procedure to ensure that clients know what they are purchasing. Consumer protection is linked to client education, but can also include legally-mandated guidelines for the terms used in insurance policies, and complaint systems to collect client grievances.

4 Conclusion

Helping poor people mitigate and plan for risks is an important priority. Insurance is just one among several strategies for coping with risk. Successful microinsurance is based on a solid understanding of client demand, and often requires partnerships across a range of stakeholders from the private and public sectors. Donors can help broker such alliances, attract private sector players, support government initiatives and fill market gaps in capacity and information. Donors are most effective when they develop the appropriate internal pre-requisites and analyse markets well before acting. They should carefully balance their role as innovators and risk-takers with a keen understanding of the possible long-term negative consequences of poorly designed schemes.

5.2 An enabling regulatory environment for microinsurance

Martina Wiedmaier-Pfister and Arup Chatterjee

The authors have received very useful feedback on this chapter from a number of people, including: Klaus Fischer (Laval University), Serap Oguz Gonulal (World Bank), Brigitte Klein (GTZ), Jeremy Leach (FinMark Trust), Hunter Murdock (attorney) and Bikki Randhawa (World Bank).

The cases analysed in this book demonstrate that low-income persons are insurable. Furthermore, there is evidence that microinsurance business operations can be sustainable. However, the question that needs to be raised is whether microinsurance operations are supported by a regulatory framework that is conducive to protecting policyholders and developing insurance markets that include the low-income segments of the population.

The primary function of insurance regulators and supervisors[1] is to protect consumers. This is manifested in at least three ways:

1. **Protecting policyholders in general** by ensuring the solvency of the insurers, which includes determining that insurance products may only be offered by licensed entities (both insurers and intermediaries) that remain financially sound and meet their obligations.
2. **Protecting individual policyholders**, including prospective policyholders, from mis-selling and improper handling of claims, and ensuring that their grievances are redressed in a timely fashion.
3. **Developing insurance markets** by improving market efficiency and including persons who currently have no access to or are unable to afford insurance through appropriate product design and delivery mechanisms.

Insurance authorities do not attach equal importance to these three aims. Much of their work is concentrated on the first two. Although improving market efficiency by correcting market imperfections is a classic task of supervisors, not all insurance authorities agree on a market development function. An analysis of the International Association of Insurance Supervisors (IAIS) database of national insurance regulations reveals that few member countries have an official development mandate. To fulfil this develop-

[1] The authors use the term "insurance supervisor" to refer to the authority responsible for regulating the conduct of insurance business – both insurers and intermediaries – to protect policyholders' interests in a particular jurisdiction.

ment function, authorities can mandate insurers to serve the low-income market, use moral suasion to impress upon insurers the need to widen their reach, or decide on a middle course. Supervisors increasingly realize that an enabling regulatory environment and better appreciation of the dynamics of the insurance market could help remove the perceived obstacles that normally discourage insurers from serving the low-income markets.

This chapter describes what supervisors have done, or can do, to support the growth of microinsurance by adapting their regulations. The chapter limits itself to the regulatory aspects of the insurance market.[2] The first section provides some background information on the regulatory environment for microinsurance. Section 2 summarizes the main regulatory barriers, which vary depending on whether one is creating a microinsurance institution or distributing microinsurance products. The third section describes the experiences in India, South Africa and the Philippines, where insurance authorities and policymakers have tried to make insurance markets more inclusive, but have chosen very different solutions. The last section summarizes the major challenges and lessons learned, and suggest possible next steps.

1 Background

1.1 Inclusive financial systems

A key strategy for enhancing economic development and alleviating poverty is to make financial systems more inclusive, for example by improving access to savings and credit services for un- and under-served markets. In part, poverty stems from the fact that low-income households and markets do not have the same opportunities to finance investments, accumulate capital or protect assets (including human assets). The poor's heavy reliance on informal financial services – such as moneylenders, under-the-mattress savings and mutual assistance societies – can be inefficient and expensive, and may even exacerbate poverty.

An inclusive financial system makes insurance available to low-income persons. However, many commercial insurers and policymakers believe that providing insurance to the poor is the responsibility of the state. Although many governments have social protection programmes, the targeting of these schemes is often ineffective. The poorest segments do not always benefit from

2 This chapter does not explore supervisory aspects of microinsurance, which are important but have not yet been sufficiently analysed since microinsurance is relatively new. It also does not consider non-insurance regulations or related policy areas that might affect microinsurance, such as the regulation of the healthcare industry or social protection policies, which are beyond the scope of this chapter.

the subsidy, while people who can afford insurance often find ways to access these benefits. In general, governments have made little effort to shift the burden of risk-pooling to market-led schemes; and the private sector (commercial insurers) seems to have little incentive to seek out this market segment.

1.2 The informality of microinsurance

In the absence of social protection and commercial insurance coverage, many informal microinsurance schemes have emerged, operating without an insurance licence. By staying small and keeping quiet, these informal providers hope that supervisors will not react. This has been the approach of many microfinance institutions that have provided insurance coverage to their members on a self-insurance basis. However, there are also large microinsurance schemes *(see Box 90)* outside the realm of prevailing insurance laws.

Another way to circumvent insurance regulations is to declare microinsurance services to be a non-pecuniary benefit. In many countries, healthcare facilities allow free or discounted access to healthcare in exchange for regular payments (premiums). Even though these schemes have a risk-pooling element, they are often called pre-payment schemes to disguise the fact that they are some form of insurance. Yet because the schemes are not licensed, the customers have little recourse if the hospital does not to keep its promises. Many credit unions or cooperatives also avoid insurance regulations by offering informal insurance as a member benefit.

Box 90

Informal insurance in South Africa

In South Africa, a number of schemes offer products that closely resemble life insurance. In the informal sector, there are an estimated 8 million members of informal burial societies contributing in excess of US$1 billion per annum in "premiums" towards coverage for the risk of death. Some of these schemes are quite large. The Great North Burial Society, a registered Friendly Society, has more than 20,000 lives covered, but has no access to reinsurance as it is not a licensed insurer.

As the Insurance Amendment Act (2003) prohibits the use of the words insurance, funeral, burial or derivatives thereof in the description and marketing of these products, they go under different names, such as "bereavement benefits" or "death benefit plans". It seems that the Amendment Act was intended to prohibit the underwriting of funeral cover without a short-term insurance licence, but legal loopholes continue to allow such informal insurance to be sold under different names.

Source: Adapted from Genesis Analytics, 2005.

1.3 The implications of the lack of a regulatory framework

Not having to comply with regulations has some advantages for microinsurers. Informal providers do not have to adhere to regulatory standards and do not have to comply with the supervisory burden (i.e. comprehensive reporting, internal controls and actuaries). They have more freedom to innovate and can potentially offer cheaper products, which may ultimately appear to benefit their clients.

However, the informal nature of these schemes also has serious drawbacks. The most obvious one is that it leaves policyholders unprotected against opportunistic behaviour. In the absence of supervision, customer protection is a serious concern. The long-term viability of these schemes is uncertain since their premiums may not have any actuarial basis, or their management may not be sufficiently skilled. Microinsurance schemes are also subject to greater covariant risk and are unlikely to have reinsurance protection. A catastrophe can pose a serious threat to the solvency of local microinsurance schemes. Finally, the growth of informal schemes can pose a threat to sustainability, e.g. when burial societies become larger, the effectiveness of the member-governance system is undermined and a separation is required between management and ownership. At this point, the burial society also accumulates substantial assets, which increases the risk of fraud or theft to a degree that member governance cannot control (Genesis Analytics, 2005).

The positive effects of providing microinsurance beyond the radar of insurance supervisors have to be weighed against its negative effects on institutions and markets, as well as on the economy. As far as the institutions are concerned, many microinsurance providers currently have no choice. If they could get a licence, they would have the chance to improve their operations, grow and attract investors. It is realistic to expect that many would opt to become a part of the formal insurance industry.[3] As a result of regulatory barriers, existing and potential microinsurance providers have remained excluded. Consequently the market remains less developed – low-income segments are not protected, government budgets are not relieved, insurance markets are not inclusive, financial innovation is sluggish and deeper penetration of financial services does not take place.

However, formalization can also be accompanied by a number of problems for insurers targeting the low-income segment. One problem is that the social orientation of some microinsurers may fade away when they become licensed. This can create new problems, such as those experienced by ALMAO *(see Box 91)*.

3 In India and Sri Lanka, microinsurers have lobbied for lower entry requirements, so far unsuccessfully.

Box 91

Formalization of ALMAO

ALMAO in Sri Lanka, which uses credit unions as its main distribution channel, changed from an informal scheme to become a regulated insurer in 2002. When subjected to regulation as a fully-fledged insurer, the organization felt compelled to change its product line. Instead of continuing to focus on the funeral policies and other simple, low-cost products it offered as an informal insurer, ALMAO introduced endowment policies that have not sold well, perhaps because the premiums are much higher than the target market was used to, and the marketing of these more complicated products required better-educated and trained staff in the credit unions. It is also possible that the professional insurance management brought in to run the new insurance company unintentionally steered the organization away from its core market, or did not consider the priorities of the credit unions and their members. The general difficulty of committing credit union staff to insurance marketing may also have increased because ALMAO became a more distant, commercial and professional organization.

Source: Adapted from Enarrson and Wirén, 2006.

1.4 Insurance supervisors and microinsurance

Some insurance supervisors are becoming more interested in and sensitive to the challenges and potential of microinsurance. In line with global efforts to increase the outreach of financial and insurance services, supervisors are increasingly mandated to facilitate their governments' efforts to relieve themselves of funding insurance and social protection schemes through public budgets, and transferring part of the basic safety net for low-income populations to the private sector. As a result, some supervisors support initiatives to make the insurance market more inclusive, so that formal insurance companies can take advantage of this new market opportunity and informal schemes can integrate into the formal insurance sector, as illustrated below in Section 3.

However, in general supervisors lack information on and experience with microinsurance and are unaware of alternative legal and regulatory regimes that encourage insurance for the poor. In some cases, policymakers believe that poor people do not want insurance or cannot honour financial obligations,[4] and that they must therefore be covered by the state or through social

[4] The experience of microfinance has shown just the opposite; often, loan default rates are much lower for the low-income market than for larger companies or the higher-income market.

security schemes. They do not as yet appreciate the role of microinsurance in financial sector development. Another widespread assumption is that existing insurance laws and regulations are non-discriminatory, which therefore ensures that low-income people have equal access to insurance – an assessment that does not stand up to scrutiny.

Even if supervisors have taken notice of microinsurance schemes, they do not see the necessity to react due to other priorities. They are often under pressure to focus on supervising commercial insurers that are a greater threat to the stability of the financial system, instead of licensing and supervising additional, often small, insurance providers that have a negligible market share, and which may require a completely different supervisory approach. Also, supervisors often do not know how they can fulfil their developmental role because innovative regulatory solutions for microinsurance remain scarce. Last but not least, in many emerging markets supervisors are often not interested in microinsurance because the insurance industry itself is still in an infant stage and they are under heavy pressure to regulate and supervise that properly.

The area of responsibility is an additional problem. Although insurance supervisors are responsible for implementing insurance regulations, microinsurance providers often operate under other authorities, such as a cooperative commission, the NGO Bureau or the health ministry. Consequently, these schemes are not seen as part of the insurance sector, even though they clearly provide insurance services. Moreover, the people responsible for supervising them generally do not have the expertise and systems to perform such supervision *(see Box 92)*.

Box 92

Insurance cooperatives in Malawi

In Malawi, the Supervision Department of the Reserve Bank of Malawi is entrusted with the task of regulating and supervising the insurance sector. The Department has limited resources; its main supervisory approach is to scrutinize reports from insurance companies. It is aware that the credit union association Malawian Union of Savings and Credit Cooperatives (MUSCCO) provides life insurance to more than 55,000 low-income persons, but claims that since MUSCCO is registered as a cooperative, it does not have the jurisdiction to support or control its activities. However, the Registrar of Cooperatives under which MUSCCO operates lacks resources, skills and interest to supervise insurance activities.

Source: Adapted from Enarsson and Wirén, 2005.

The very existence of informal insurance suggests that existing laws and regulations in some ways impede the inclusiveness of the formal insurance market. The question for insurance authorities and policymakers is: what should they do to remedy this situation? Leach (2005) identifies the balancing of stability and access as a regulator's dilemma.[5] Should they try to formalize informal schemes to enhance consumer protection, which could stretch supervisors' resources to the breaking point? Should they shut down informal schemes since they are essentially illegal? If informal schemes are allowed to operate, how should they determine the threshold that triggers regulatory intervention? Or is there some middle ground that could expand access to insurance with some degree of consumer protection?

2 Barriers in existing regulatory frameworks

There are conflicting views among insurance supervisors on the extent to which regulations should be adapted to the specific characteristics of microinsurance. According to a survey conducted by the IAIS, the majority of supervisors believe that the existing laws and regulations in their jurisdictions do not discourage microinsurance. However, very few jurisdictions have laws or regulations adapted to encourage microinsurance. This section considers the regulatory barriers that limit the creation of microinsurance companies as well as those that impede the proliferation of microinsurance products.

2.1 Regulatory barriers to creating formal microinsurance institutions[6]

A cautious approach treating microinsurance on a par with commercial life and non-life insurance actually discourages the development of microinsurance. Such a "one-size fits-all" policy makes the job of the supervisor easier, but lacks a convincing rationale. The insurance requirements described below are barriers to microinsurance formalization.

Where there is only one institutional option, **high capital requirements** can impede the establishment of regulated insurance institutions dedicated to the low-income market since amassing the volume of small policies required to generate a return on such an investment could take years, if it ever occurred at all. Furthermore, imposing high capital requirements designed to

5 Leach (2005) identifies three dilemmas for financial sector regulators: 1) the trade-offs between stability and access (which only partly relates to the issue of regulating informal providers), 2) managing innovation and 3) handling international pressure to conform to standards and codes.

6 Formal microinsurance entities can be either companies (first-tier institutions) or member-based institutions under a lower tier.

protect the financial system seems inappropriate for such small policies – a capital sledgehammer to crack a solvency nut. The current trend toward raising capital requirements in many countries may force existing microinsurers to close down *(see Box 93)*. Their existing policyholders, in the absence of alternative sources of coverage, risk having no protection in the future.

Box 93

Capital requirements in Peru

In Peru, the insurance law issued in 1993 did not promote insurance products for the low-income market. Higher capital requirements were introduced and caused some insurance companies to merge, while others left the market altogether. From October 1994, SEGUROSCOOP, a low- and middle-income segment insurer, had to cease operating as an insurance company. However, it found a solution: it formed a new company called ServiPerú that offered social security services, i.e. health and funeral services. It also created a subsidiary insurance brokerage and transferred its insurance portfolio to an insurer. As an insurance broker, ServiPerú is supervised by the Banking and Insurance Superintendence. As far as the social security services are concerned, ServiPerú is under the control of the Supervisory Commission for Enterprises and Securities (not governed by the insurance law). Although not an ideal solution, the former insurer found a new way to operate (new company structure, new products, and new distribution channel), stayed in the market and continued to serve its clients.

Source: Adapted from Rodriguez and Miranda, 2004.

There are a number of other requirements in insurance laws and regulations that prevent microinsurers from getting a licence, such as the high **requirements for key management**. Highly-qualified insurance managers are unlikely to opt to lead a microinsurance organization, which generally offers a lower salary and fewer career options than a commercial insurer. Obviously it is necessary to have qualified people running the company, but should the qualifications be relaxed for microinsurers?

Complex reporting requirements can make the cost of management and administration prohibitively expensive for small microinsurance operators. If reporting and disclosure requirements, originally designed for large insurance companies with complex structures, are imposed on microinsurers with simple procedures, costs will rise. Similarly, the **requirement to have an actuarial review** can be expensive and difficult to fulfil in some jurisdictions. This regulatory burden, perhaps coupled with a **premium tax**, adds to the cost of the product and leads to a reduced level of access for the poor.

These aspects need to be analysed to appreciate where entry barriers can be lowered to promote microinsurance. Certainly, supervisors appear justified in not licensing insurance entities with weak management and low capital. However, it is questionable whether organizations which are often locally-based and oriented towards the low-income market should be denied a licence on the basis of requirements that are neither relevant nor appropriate for the types of services that they offer. This is particularly true for mutuals and friendly societies, for which a long legal tradition exists of requiring no capital at all since risk is borne by the membership.[7]

Without a licence, the microinsurer is trapped in a vicious circle: no access to sources of additional capital or reinsurance, which ultimately means no growth for a prudent operator. If these schemes cannot grow, then it will be difficult for them to achieve economies of scale and extend coverage to the vast unserved market. In such an environment, policyholders are not protected[8] and the institutional learning curve is not inspired by external control (supervision) and high standards (regulation). The only advantage that supervisors enjoy is that they do not have to deal with many small insurance schemes.

2.2 Regulatory barriers to distributing microinsurance products

As mentioned in numerous chapters, one approach to expanding microinsurance services is for a regulated insurance company to offer a product line that reaches the low-income market through alternative distribution mechanisms, including community organizations, banks, retailers, cell phone companies and others. However, regulatory barriers can also inhibit the use of these distribution channels even though they might be effective in reaching low-income markets. Supervisors need to monitor trends to ensure that regulation is not restraining the innovation by distribution channels in a way that is detrimental to market development (Leach, 2005).

Microfinance institutions (MFIs) are a key distribution channel for microinsurance because they already engage in financial transactions with the low-income market. However, in some jurisdictions, MFIs – and other institutions that work closely with the poor – cannot distribute insurance without conforming to stringent **licensing requirements for agents or brokers**. For example, the requirement that an agent has to be a private person may

7 This is the case in Belgium, France, Germany, Ireland, Japan, United Kingdom and United States (practically all states), as well as Belize, India, Mali, Martinique and South Africa among others.

8 Commercial insurance regulations often stipulate cumbersome practices that are inappropriate for low-income customers, who may be illiterate and understand little of insurance. This result is ironic since this target market requires even more consumer protection.

not allow MFIs to sell insurance. The requirement for specialized staff to sell insurance undermines the efficiencies that are possible by selling insurance through loan officers and tellers. Some jurisdictions prohibit lending organizations from selling insurance altogether, citing conflict of interest.

Furthermore, the training requirements to become a licensed agent may be excessive given the simplicity of microinsurance products. Should a poor housewife who wants to sell US$500 endowment policies to her friends and neighbours have to go through 100 hours-worth of training? In some jurisdictions, the licensing requirements for agents are not strictly enforced, allowing MFIs and microinsurers to sell insurance, albeit in a potentially vulnerable legal situation *(see Box 94)*.

Box 94

Requirements for agents and brokers

In the **Philippines**, the Insurance Commissioner (IC) licenses agents that have fulfilled certain criteria (e.g. payment of a registration fee, passing an exam, and no criminal record). An agent has to be a private person. However, several MFIs in the Philippines collaborate with Cocolife to insure more than 300,000 poor households – although these MFIs are not registered as agents. They sell Cocolife's products, but do not receive a commission. Instead they load the net premium charged with an administration fee that is paid by the client to the MFI at the start of each loan (Leftley, 2005).

AIG **Uganda** has a partnership with 26 MFIs in three countries to cover over 1.6 million lives. In Uganda, any individual selling insurance as an employee of an MFI would technically need to be licensed, though in practice none are. As a consequence, the MFIs' credit officers often lack the skills to sell insurance and to advise customers (McCord et al., 2005a).

In **Bangladesh**, insurance agents also need to be licensed. This may help to ensure a minimum level of agent quality; however, it may also make it difficult to serve the rural poor. Delta Life, for example, certifies the agents for its mainstream products that target middle- and higher-income persons in urban areas. However, it calls its microinsurance agents "organizers" to avoid licensing requirements. Another complication is that agents are eligible to continue to earn commission on renewal premiums even after they have left the insurance business, which creates additional administrative complications when dealing with hundreds of thousands of very small policies, and thousands of organizers (McCord and Churchill, 2005).

Restrictions on the amount of agency commission that can be offered by an insurer to the agent may also hinder microinsurance provision. The justification behind this clause is to protect the life fund from becoming depleted due to expensive distribution structures. However, such clauses may create a problem for microinsurers, since low-income markets are more expensive to serve and may justify a higher cost structure.

Where microinsurers offer long-term policies, the prescribed commission structure may not be appropriate. For example, the commissions approved by the Insurance Board of Sri Lanka (IBSL) pay 30 per cent in the first year, but drop off to 5 per cent after Year 4. In an environment where banking or postal payment systems are not widely used, the agent is responsible for collecting premiums, often by going door-to-door. Given the required commission structure, Enarrson and Wirén (2006) argue that the retention rate is likely to go down drastically when the agent's commission is reduced since it is much more attractive to recruit new clients than to collect premiums from old ones. Therefore, one can expect a high lapse rate that will undermine the credibility of insurance among the low-income market.

Another product-related regulatory barrier is the fact that insurance companies cannot underwrite **composite business**, even though it might be an appropriate product structure for the low-income market.[9] In many jurisdictions, licensing requirements do not allow the formation of composite insurance companies, but require separate companies for life (long-term) and non-life (short-term) business. The protection achieved by not mixing long-term and short-term liabilities is justified for commercial lines of insurance or for policies with large sums insured. However, the same logic does not apply to microinsurance, where policies generally do not go beyond five-year terms, and the vast majority are for one year or less *(see Box 95)*.

Box 95

AIG Uganda

AIG Uganda covers many microfinance borrowers, but with a non-life licence, it can only provide accidental death and disability insurance. However, the poor do not differentiate between different types of death. It does not matter whether one dies in a car accident, or from malaria or a heart attack. These microfinance clients want protection regardless of the cause of death. AIG Uganda cannot legally provide life coverage even though most terms are only four or six months (corresponding to the MFIs' loan terms).

Source: Adapted from McCord et al., 2005a.

As regards **suitable types of products for low-income segments**, it appears that group products are the most appropriate. It is unclear whether endowment policies should be recommended for microinsurance clients at all. Endowment policies require a savings discipline that low-income segments often do not have due to fluctuations in their household cash flow,

9 Arguments for and against composite or basket covers are presented in Chapter 3.1.

which leads to high lapse rates *(see Chapter 2.2)*. Furthermore, endowments may actually be a poor form of savings for these households due to the insurer's high cost structure and taxation requirements.[10]

Policy wording requirements are sometimes unsuitable for low-income clients, who are often illiterate (even educated people cannot understand most insurance contracts!). Insurance policies for the poor should be written in very simple language without legalese, so as to ensure that the terms and conditions are easily understood.

In jurisdictions where a **tariff regime** is in vogue, the rates, policies, terms and conditions are standardized either through industry practice or regulation. Although such a regime may appear to have several advantages, it can also hamper innovation and competition, which are particularly important for microinsurance.

2.3 Macro-level barriers

There are other barriers related to policy and legal framework, the implications of which are not yet properly understood, but which are nevertheless worth identifying. Firstly, some jurisdictions may face **over-regulation of the insurance sector in general**. For example, some countries restrict foreign investments in the insurance industry, which makes it difficult to transfer know-how to make delivery of microinsurance products and services more effective and efficient. Furthermore, protectionist policies may require the purchase of over-priced and/or low-quality domestic reinsurance.

Secondly, **overlapping regulations** can create complications for microinsurance design and delivery. For example, in South Africa, a large burial society needs to have a legal personality (registered with the Department of Trade and Industry), be registered as an insurer (financial services regulator), may be supervised by an apex or self-regulatory body,[11] and if providing an in-kind benefit (funeral services), be regulated by the Department of Health.

Thirdly, when **governments maintain or launch subsidized insurance schemes**, they do not usually consider whether these schemes could be offered via market mechanisms. An analysis of whether these schemes could be maintained without a subsidy is not carried out. Instead of popularizing the existing schemes, such government action undermines microinsurance

10 For example, low-income households are often tax-exempt, implicitly or explicitly, while the insurance companies pay corporate taxes on the investment returns, and therefore the return to the policyholder is net of tax.

11 Among mutual institutions, apex organizations often play an important role as regulators, not only in insurance but also in the savings and loans market.

providers as policyholders migrate to the subsidized scheme. As a result, the strains on budgetary resources remain and the subsidies are often not employed or targeted properly.

3 Country experiences – preliminary insights

Despite the wide-ranging and complicated regulatory barriers, there are solutions, some of which are actually being implemented. Several countries have adapted their regulatory frameworks to microinsurance.[12] This section describes the experiences in India, South Africa and the Philippines, which employ different strategies to overcome regulatory obstacles to the expansion of microinsurance.

3.1 India

India's Insurance Regulatory and Development Authority (IRDA) has taken a proactive approach in promoting microinsurance by obliging insurance companies to serve the poor in the hope that this forced familiarity will help insurers see the potential of the low-income market. In what is essentially a quota system, all insurance companies are obliged to underwrite business in pre-defined rural areas[13] and in the social sectors.[14]

The evidence from these quota requirements is mixed. Failure to attain the targets has resulted in financial penalties for some insurers, and repeated violations could cause an insurer to lose its licence. Some insurers perceive the requirements as a cost of doing business and dump poorly-serviced policies on the market. Other insurers like ICICI-Lombard and Tata-AIG now consider the poor to be a viable market opportunity and have voluntarily exceeded their quotas, so the forced familiarity approach could be paying off. The extent to which this quota system is replicable in other countries remains doubtful since it is not in line with market-led policies for financial systems development.

12 India, Morocco, Trinidad & Tobago, the Philippines and Japan are among the few countries where regulations have been adapted to microinsurance. South Africa has adaptations in progress.

13 Rural areas are defined by the Census of India as places which simultaneously satisfy or are expected to satisfy the following criteria: (i) a minimum population of 5,000, (ii) at least 25 per cent of the male working population engaged in agricultural economic pursuits and (iii) a population density of at least 400 per square kilometre (1,000 per square mile). In these areas, life insurance must account for 5 per cent of total policies in Year 1, rising to 16 per cent from Year 5 onwards and general insurance must be 2 per cent of total gross premium written in Year 1, rising to 5 per cent from Year 3 onwards (IRDA, 2002).

14 The social sectors are defined as "unorganized workers, economically vulnerable or backward classes in urban and rural areas". Here, each insurer has to maintain at least 5,000 policies in Year 1 rising to 20,000 in Year 5, for both life and general insurance. This is regardless of the size of operations (IRDA, 2002).

To assist insurance companies in complying with these requirements, the IRDA has recently issued new microinsurance regulations to actively facilitate partnerships between regulated and unregulated entities (IRDA, 2005). These new requirements are designed to ensure that risk carriers remain supervised, but allow them to explore different distribution channels to extend insurance to the poor.

The regulation creates a new intermediary, the microinsurance agent, which can be an NGO, MFI or other community organization appointed by an insurer to distribute microinsurance through specified persons. Microinsurance agents enter into a "deed of agreement" with the insurer. They abide by the code of conduct defined by the IRDA and attend 25 hours of training (down from 100 hours for conventional insurance agents) in the local language at the expense of the insurer. There is no qualifying examination, as is the case with ordinary insurance agents. A cap is put on commission, between 10 and 20 per cent of premiums per year according to type and mode of insurance payment, which is in excess of what conventional agents would normally earn.

The new regulation also allows for the bundling of life and non-life elements in one single product provided there is clear separation of premium and risk at the insurers' end. Parameters of the microinsurance product are also regulated *(see Table 48)* and are subject to actuarial sign-off and "file and use" requirements. Products beyond the prescribed sum insured do not qualify as microinsurance and therefore the licensed agents would require more expertise.

Table 48 **Definition of microinsurance in India**

Product line insured (Rs.)	*Minimum sum of cover (years)*	*Maximum sum*	*Term insured (Rs.)*
Life	5 000 (US$113)[15]	50 000 (US$1 130)	5
Non-life	5 000 per asset	30 000 (US$678)	
Health	5 000	30 000	1
Personal accident	10 000 (US$226)	50 000	1

This regulation is seen as an important step towards expanding microinsurance in India. However, critics argue that this regulation is very narrow because it focuses on just one approach, the partner-agent model. They also argue that product details should not be centrally regulated. Since the high-minimum capital requirement for an insurance company (US$22 million) has not been lowered, there is perhaps insufficient competition among risk carriers. In response to this last point, the supervisor has recommended to the

15 US$1 = Rs. 44.25 (Indian Rupee)

government that the capital requirements for health insurance be reduced by half to increase the number of health microinsurance operators.

The new microinsurance regulations show one path to enhancing distribution efficiency, by a partial relaxation of training and remuneration norms and by the bundling of products, without compromising the risk-taking ability of a commercial insurer.

3.2 South Africa (SA)

Microinsurance in SA has been undertaken for many years, just not under that name. The most common form of microinsurance is funeral insurance (often offered under an Assistance Business Licence in SA), which is "a life policy in respect of which the aggregate value of the policy benefits, other than an annuity, to be provided....does not exceed R10,000 (US$1,500)[16] or another maximum amount prescribed by the Minister". The Assistance Business Licence then allows uncapped commissions. The Friendly Society Act allows for cover up to R5,000 (US$750). All other funeral insurance providers have to register under the Long-Term Insurance Act, which requires minimum capital of ZAR 10 million (US$1.5 million). They can offer funeral insurance for any sum assured, but their commissions are capped (Genesis Analytics, 2005).

Most microinsurance in South Africa is generated by the funeral industry, which has been in the low-income market for some time, but the market is still under-served. The question is how to expand funeral services in a sustainable manner. In this regard, the SA Financial Services Board (FSB), the non-bank regulator and supervisor, faces a significant dilemma. A large proportion of funeral insurance is effectively unregulated since the main providers – burial societies and funeral parlours – are registered under the Friendly Societies Act. The supervisor is concerned about the continued viability and sustainability of this model, and the ability of existing providers to manage their risks in the future.[17] In the event of failure, the insurance supervisor, as well as the insurance industry, would face a reputation risk and market confidence could be devastated. Instead of being reactive, the supervisor, the government and the existing industry are considering proactive steps.

South African supervisors have not intervened as directly as their India counterparts to legalize and promote microinsurance. Rather, they rely on

16 US$1 = R6.65 (South African Rand)

17 Besides revealing the significant scale of burial societies in South Africa (see Box 90), the FinScope Africa surveys of financial services (www.finscopeafrica.com) indicate that informal mechanisms are not ideal: 9 per cent run out of money to pay claims and 4 per cent suffer from fraud. Default rates at these levels among formal insurers may be seen by regulators as a systemic problem, particularly because of the large numbers of people affected (Genesis Analytics, 2005).

the Financial Sector Charter,[18] whereby all financial service providers have agreed to voluntarily serve the low-income market. Consequently, the SA insurance industry has experienced a huge wave of innovation as insurers experiment with new delivery channels to reach the poor, including joint ventures and partnerships with retailers (*see Chapter 4.6)*. It is too early to assess whether the new wave of innovation will succeed. At present, less than 1 per cent of SA's poorest 60 per cent have short-term insurance (i.e. non-life), which has to be raised to 6 per cent if the Charter's targets are to be met. To assist companies in meeting the targets, the FSB is responsible for promoting consumer education. Therefore, the FSB has a massive role to play in terms of facilitating, funding, monitoring and coordinating better consumer education.

At present, there is an initiative to create a more level playing field and to remove burial societies and funeral parlours from the Friendly Societies Act to a parallel Cooperatives Act which is more suitable in the SA context. The development of this new tier will comprise a dedicated funeral insurance licence available to all players in the market, with reduced entry and compliance requirements. The new tier should be accessible to both member-based and commercial insurers. Small, member-based burial societies should come under the new Cooperative Bill.

3.3 Philippines

In the Philippines, the insurance supervisor has created a two-tier system, similar to the tiered regulatory environments that have emerged for microfinance. To create a life insurance company under the first tier, it takes Php 50 million (about US$1 million) and for non-life Php 100 million (US$2 million).[19] The Insurance Commission (IC) of the Philippines plans to increase the minimum capital requirement for all new insurance players.

The second tier comprises mutual benefit associations (MBA), an institutional form created by the IC under the ambit of the insurance law. Although most MBAs are small and unregistered, once they become significant enough to be "noticed" in terms of volumes and membership numbers, they need to be registered, i.e. licensed by the Commissioner.

18 The Financial Sector Charter (2003) in South Africa was originally conceived as a transformational blueprint for the financial services industry, i.e. de-racializing the financial sector in terms of its – hitherto predominantly white – ownership, employment and procurement practices; however, it also includes very specific targets for an improvement in financial access. Signatories of the Charter include government, industry bodies and representatives of labour and civil society. In specific terms, banks and insurers have committed to provide certain products and services to lower-income people by 2008.

19 US$1 = 52.87 Php (Philippine Peso)

According to the Mutual Benefit Associations Act,[20] such associations are subject to supervision and need to have access to an actuary. An MBA must deposit US$182 as initial capital and continue to contribute to a guarantee fund at least 10 per cent of its assets, up to the minimum capital required for a fully fledged insurance company. MBA licensing and supervision provides some protection for members since the supervision reduces the scheme's vulnerability to fraud and mismanagement. The IC has established a special MBA unit to supervise them.[21] Nonetheless, in practice, it does not aggressively challenge non-registered MBAs due to its limited supervisory capacity, which raises doubts as to the degree of consumer protection under the current arrangements. Agents of MBAs do not require licences.

One problem with this arrangement is the high income-tax differences between commercial insurance companies and these second-tier institutions, which can be a deterrent to conversion into a first-tier entity. For example, CARD MBA, which provided life insurance to more than 600,000 poor Filipinos in 2004, originally planned to become a fully fledged insurance company. This plan has not progressed, however, due to the high tax burden on insurance companies, even though CARD MBA would have a number of interesting business opportunities as a first-tier insurer.

Although this tax issue is not directly in the realm of insurance supervisors, they are in a position to provide relevant input and convey it to the policymakers. In the present situation, when governments in many countries are looking to promote alternative market-based mechanisms to provide protection for the lives, health and assets of their population, policymakers may find merit in such proposals.

Some MBAs are registered as such to take advantage of more favourable tax conditions (regulatory arbitrage) and some MBAs are not in the best of financial health, possibly due to mismanagement, among other reasons. In recognition of these problems, the IC plans to adjust the MBA regulation in the near future.

4 Conclusions

The starting point for creating inclusive insurance markets is for supervisors to have a mandate to do so. If insurance supervisors are to comply with this mandate and take their market development responsibilities seriously, they need instructions from policymakers to the effect that this is indeed a priority. Such instructions make sense, given the role of insurance in achieving the

20 Chapter VII of the Insurance Act (Sections 390–409).

21 In 2001, 18 out of the 32 licensed MBAs (56 per cent) were inspected on-site.

Millennium Development Goals *(see Chapter 1.1)* and the limited resources available for publicly-sponsored social protection benefits *(see Chapter 1.3)*.

The major challenge for supervisors is to create an enabling environment for outreach and sustainability of the growing microinsurance market. From the policyholder's perspective, supervisors need to guarantee that the increasing number of semi- or informal microinsurance schemes fulfil their obligations to their members. The protection of poor people's scarce funds is a critical concern.

It is quite difficult to provide this consumer protection while at the same time encouraging innovative solutions to respond to the insurance needs of low-income households. Adjustments to regulatory frameworks are often perceived as being in conflict with prudential principles and risk creating distortions in the market place. Therefore, supervisors have to find a balance that promotes inclusion – which means extending insurance to the huge low-income market while protecting their investments and confidence – without putting an undue burden on supervisors. This is not an easy task.

Since high capital requirements are inappropriate for small microinsurance policies, one solution which needs to be further explored is the risk-based capital (RBC) approach. RBC represents an amount of capital that a company should hold to protect customers against adverse developments based on an assessment of risks. It is typically calculated by applying factors to accounting aggregates that represent various risks to which a company is exposed. Risk-based supervision has become recognized as an international standard, endorsed by the IAIS and the developed market supervisors.

Each jurisdiction has its specific features and there is no one solution that fits all. This is illustrated in the examples from India, South Africa and the Philippines, where each country has adopted a different approach. India compels insurers to serve the poor and has made some critical regulatory adjustments by reforming its broker/agent regulation, which may be the easiest way to stimulate the increased provision of microinsurance. South Africa, on its way to a new framework for microinsurance, is cautiously approaching its enormous informal insurance industry. The supervisor wants to extend consumer protection to those who have informal insurance, but does not want to regulate the schemes out of existence. The solution found in the Philippines is to build on the strength of mutual schemes. The model of the guarantee fund, tied to volumes and not requiring much initial capital, is an appropriate mechanism for providing consumer protection for these second-tier providers.

The revision of agent and broker licensing requirements could be the fastest and easiest way of stimulating increased provision of insurance services, while the creation of a new tier of institutions might be a major step forward, but could require some time and effort. In addition, the emergence of third-party administrators could be important, since microinsurance is a high-volume, low-margin business that requires considerable administrative expertise. It is also useful to consider alternative distribution channels; retailers and cell phone companies – any organization that engages in financial transactions with the low-income market – could distribute microinsurance.

There should be a coherent, principles-based regulatory framework to take into account the different institutional requirements for microinsurance. Such a framework does not necessarily mean a separate law for microinsurance, as in the case of India. It could also comprise amendments to the insurance act, as in the Philippines. Rather than shoehorning all insurers into one common set of regulations, this framework approach requires differentiated rules and regulations for different provider models. In other words, special institutional options for microinsurance are likely to be more effective in enhancing the inclusiveness of the insurance industry than the standard regulation with a single tier.

Microinsurance promotion implies that policymakers and supervisors take concrete steps, while understanding that incorporating microinsurance schemes into the regulated sphere imposes costs on supervisors as well as on the microinsurers, which may have to be passed on to the policyholders. In addition, one has to look critically at the threat that the formalization of informal schemes may result in a loss of social orientation.[22]

Good supervision requires insurance-specific technical competence. It is certainly not appropriate to delegate responsibility to other government authorities. In the same line, the capacity of insurance supervisors is a serious consideration. It is unrealistic to promote adjustments to the regulatory environment that will result in an increase in regulated insurers, some of which will need different supervisory approaches, without building up the capacity and resources of insurance supervisors.

A critical question is how to react to small schemes that are not (yet) able to adopt the commercial orientation required for a formalized institution. It is important to define a threshold where formalization is required and where regulation needs to be imposed (Genesis Analytics, 2005). Microinsurance operations up to this threshold would then be exempted from supervision. However, once the threshold is crossed, such entities need to be formally licensed.

22 In microfinance, the data show that the correlation between formalization and mission drift is much weaker than suspected, and was never considered to be a serious problem. This might be partly related to the fact that finding "real commercial" owners was, in most cases, not an urgent necessity for the transforming MFIs due to the many development-oriented investors available.

An intermediate step for smaller microinsurance providers that are too large to operate outside the regulatory radar, but still too weak to apply for a licence for fully fledged insurers, could be self-regulation (market-conduct standards) organized by an apex body. Self-regulation may help the industry to some extent, but can never free insurance supervisors from their responsibilities. This approach would only be feasible in countries with a significant number of providers (Genesis Analytics, 2005).

Microinsurance straddles the boundary between government-provided social protection and market interventions. Consequently, intensive stakeholder dialogue is required to ensure compatibility and cohesiveness of both private and public policies. For example, an insight into the pricing mechanism of insurance schemes subsidized by governments could provide a benchmark showing how such schemes would have worked in the absence of subsidy. In addition, it also provides evidence on the merits of public-private partnerships for ensuring better servicing, lowering costs and subsidies and directing subsidies to the most vulnerable segment of the population. Clear rules need to be defined in terms of accounting and solvency norms to segregate government-subsidized products in an insurer's portfolio.

Finally, for regulatory adaptations to work, there needs to be a significant investment in education at many levels. Policymakers and supervisors have to understand the risks and potential of microinsurance, and therefore know-how transfer and dialogue are primary concerns. Donors and other promoters are also learning and have to be prepared to finance and technically assist supervisors as well as microinsurance providers. Finally, the customers who demand microinsurance services are not well-educated; governments and donors have to assume a role in this area. These challenges have to be dealt with alongside the regulatory and supervision aspects.

5.3 The promotional role of governments

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Protection against risks is a citizen's right. Therefore, it is a responsibility of the state to use all possible means to deliver this public good and to create an environment in which equitable access to social protection systems is promoted (ILO, 2002c).

Governments can play different roles when trying to fulfil this responsibility. Firstly, as discussed in Chapter 1.3, governments can provide social protection, such as universal healthcare, workers' disability benefits and old-age pensions. However, the fiscal income of governments is constrained. In many developing nations, no more than 20 per cent of the active population is usually included in regular social security systems (ILO, 2000). Many governments are currently unable to provide these fundamental services to the vast majority of their citizens.

Secondly, governments are responsible for regulating and supervising the insurance industry, which provides valuable protection to the country's businesses and citizens, especially to those able to pay for it. If the government is unable to provide an appropriate degree of social protection itself, it should at least create an environment in which the market can extend protection systems to under-served segments. As described in the previous chapter, adjustments to insurance law and regulations may do much to enable commercial insurers to serve the low-income market.

However, even in a regulatory environment conducive to microinsurance development, market forces alone will not solve the problem of insufficient social protection coverage. On a purely commercial basis, microinsurance – with its small transactions, low premium income, relatively high administrative costs and hard-to-reach target market – is not particularly attractive to most insurance companies. Where coverage and quality of formal social security schemes are limited, and where insurance companies are not extending services to the poor, governments need to explore other options to increase social protection coverage.

This leads to a third approach, where governments play the role of facilitators to help overcome market imperfections by promoting microinsurance through a variety of institutional options. In this promotional role, governments could even use their finite resources to promote additional investments from the private sector to provide protection. This chapter describes this third function and illustrates ways in which governments can promote microinsurance.

1 Policy-making, participation and consensus-building

If a government considers social protection a policy priority and if it feels microinsurance can supplement other aspects of a comprehensive social protection scheme, it may decide to actively promote this approach. Before doing so, it is likely to weigh the potential of microinsurance against its limitations. Governments should involve all key stakeholders at an early stage in this process of discussing and formulating policies.

Microinsurance is neither the only, nor necessarily the best possible alternative to protect the target population against the most significant risks. Most schemes reach only a fraction of the population and do not solve the problem of access for the poorest and most vulnerable groups, who cannot afford contributions and have protection needs beyond what microinsurance can offer. It would, therefore, be unrealistic to assume that microinsurance could cover everyone not covered by existing formal schemes. Yet it can play a contributing role; what exactly that role is will depend on the political process.

Decisions on public policies – particularly in the context of social matters – are essentially political, as they involve a number of fundamental, yet subjective questions that need to be explicitly addressed in a comprehensive public policy on social protection. What is, for example, the desired level of solidarity? A first step in the formulation of a policy on microinsurance is for the government to facilitate a participatory process that assesses whether the nation's social goals may be effectively and sustainably pursued through microinsurance. In this context, the extent of a government's commitment to its social objectives is important in determining whether and how it should become involved in microinsurance. A national policy framework should define the role of microinsurers in the larger context as well as the particular roles of the government and other stakeholders.

It is crucial to involve all key stakeholders in the process of formulating policies if they are to be widely accepted and broadly supported by the majority of the population. The stakeholders include civil society groups (e.g. religious bodies, NGOs), cooperative-type self-help organizations and their apex bodies, and commercial domestic and international insurers. Other important players in microinsurance include employers' and workers' organizations, service providers, professional associations and bi- and multilateral development partners.

Success in promoting microinsurance depends on close partnerships between all stakeholders; however, certain activities can only be provided by the state, such as the creation of legal frameworks and the provision of services that no commercial player would be able or willing to offer. Public-private partnerships (PPPs) may have particular relevance where national resources and know-how are limited. For example, one of the largest insurance companies in the world, Allianz AG, has teamed up with GTZ and UNDP to develop microinsurance products in India and Indonesia.

The overall process of participatory policy-making needs to be facilitated by the government, which requires the political will to do so. In this context, a technical problem can be that workers in the informal economy are often too insufficiently organized to communicate their needs to the government (Carrin, 2002). Politically, it may be difficult to arrive at a consensus on the degree of solidarity and redistribution required to extend social protection coverage to the whole population. It takes a lot of political will to extend coverage to the poorest since the issue of reducing their vulnerability competes with other priorities.

Among the key issues to be decided by stakeholders is the definition of the microinsurance concept, for which there is a range of options. For example, which delivery model(s) should be given priority – cooperative-type self-help organizations, partner-agent models, community-based insurance schemes, direct sales models or a mixture of some or all models? Other questions are those relating to compulsory or voluntary membership, the degree of co-financing or premium subsidization, and the admission of index-based risk management schemes or derivates (e.g. weather-index-based insurance schemes).

Depending on the specific circumstances in a country and after consultations with major stakeholders, the government needs to choose the most feasible options for the promotion of microinsurance. Careful evaluation allows the prioritization of possible instruments and ensures the selection of those with the highest potential impact on the nation's social objectives relative to their cost. The various tools or options at the government's disposal include: (a) creating an enabling environment, (b) strengthening institutions and (c) providing financial assistance.

2 Creating an enabling environment

Although often associated with the legal and regulatory framework, an enabling environment actually encompasses a broad range of areas. In fact, virtually every government activity, from law-making to the provision of public services (e.g. basic health, basic education, physical security and labour market policies that promote decent work) could be seen as contributing to an enabling environment. By identifying possible environmental or infrastructure obstacles that impede the development and expansion of microinsurance, governments may be able to make adjustments through limited investments that could significantly increase the availability and quality of insurance to the poor.

2.1 Legal and regulatory framework

Many microinsurance providers operate outside the insurance laws where neither the interests nor the funds of consumers receive adequate protection. As described in the previous chapter, a well-designed regulatory framework is a major factor in the effective and efficient provision of microinsurance services.

Apart from a specific law for microinsurance institutions, a number of additional legal regulations influence the creation, operation and expansion of microinsurance schemes:

- The regulatory framework for microfinance institutions (MFIs) that may act as brokers or delivery channels
- Laws for other types of institution such as cooperatives
- The entire legal framework for the insurance market including reinsurance
- Government accounting regulations aimed at preventing fiscal irregularities
- Tax laws

to mention just a few.

Policymakers have to ensure the consistency of policies, laws and regulations relating to microinsurance. Thus, a systemic approach to policy-making is required.

The regulatory framework determines, for example, whether non-profit organizations, cooperatives and community-based microinsurers are formally allowed to enter the market. Moreover, it defines the scope for private initiative, e.g. whether commercial insurers are given additional, mandatory responsibilities through a quota system for the poor as in India. As an alternative to forcing insurers to enter the low-income market, they could be encouraged to do so through incentives, for example by offering tax advantages to private-sector insurers that offer products to the poor. In such a situation, it is important to recognize that the low-income market may require a different type of consumer protection *(see Box 96)*. In addition, it may be necessary to explore ways of extending consumer protection to policyholders in informal insurance schemes.

Box 96

The Insurance Ombudsman Sri Lanka

The new office of the Insurance Ombudsman in Sri Lanka was opened on 1 February 2005. The positive experiences from the Financial Ombudsman Scheme in Sri Lanka led to the establishment of this new office. The objective of the Insurance Ombudsman is the satisfactory settlement of complaints by and disputes with policyholders of insurance companies covered by the scheme, which include ALMAO (All Lanka Mutual Assurance Organization) now that it is a regulated insurance company. The Ombudsman has the power to make monetary awards that are binding for the participating insurance institutions.

Apart from the primary function of attending to complaints, the Ombudsman engages in efforts to create greater awareness about insurance among people in Sri Lanka. Given ALMAO's outreach to the low-income market, both the social marketing and the complaint-processing approaches will need to be adapted to the characteristics of ALMAO's policyholders.

Source: Adapted from Enarrson and Wirén, 2006.

2.2 Risk prevention and social marketing

Governments can play a key role in risk prevention and reduction. At a macro level, preventive policies to mitigate the impact of events such as economic crises, natural disasters and social conflicts can create a stable environment in which microinsurance schemes can thrive. In addition, risk-reduction activities such as improved flood protection systems, improved sanitation, preventive healthcare and effective monitoring of communicable diseases can significantly lower risk and, therefore, claims expenses, thus reducing insurance premiums and making insurance products more affordable for the poor *(see Chapter 3.9)*. Naturally, these are initiatives that governments would want to initiate for citizens in general, not just to bolster microinsurance schemes.

Moreover, governments can also move towards more equitable and inclusive labour markets. Since labour is often poor people's main or only asset, equitable access to decent work is one of the most important aspects of risk reduction. Furthermore, the speed and quality of economic growth needs to be optimized, while increasing employment elasticity and the share of formal work in total employment; both will facilitate the ability of governments to mobilize compulsory funding for universal coverage (WHO, 2004). Lastly, the more the formal sector expands, the less alternative insurance mechanisms are needed, since formal sector workers are easier to provide with adequate formal social security coverage.

Besides taking direct action to create a healthier living environment for the poor, the government can also be involved in social marketing campaigns to build greater awareness and understanding among citizens of the significance of risk prevention and risk avoidance. Several microinsurance schemes, including BRAC and Grameen Kalyan in Bangladesh, participate in the government's immunization programme campaign directed at children. Vaccines are provided free of charge by the health authorities and small contributions are made to cover the cost of promoting the campaign. Such participation may strengthen the schemes' own prevention programmes and enhance their public image. However, evidence from public health campaigns suggests that they have not always been effective in changing people's behaviour.

Social marketing can also extend to promoting risk-management strategies and trying to create an insurance culture. Indeed, the lack of an insurance culture is regularly identified as a major obstacle to the expansion of microinsurance, and one that the government could address with limited resources. The government could either undertake this itself or encourage the insurance industry to assume responsibility.

Sensitization campaigns on the characteristics and specific advantages of microinsurance might explain how to participate in and set up schemes and describe the rights and obligations of policyholders, as well as the costs of cover, which are often overestimated, and the costs of not having social insurance, which are usually underestimated (GTZ, 2005). Social marketing might help reduce consumer misconception and unrealistic expectations, which can represent a major obstacle and lead to mutual lack of understanding (Huber et al., 2003).

In Guatemala, for example, one of the key themes of the Banking Superintendency (which includes the Insurance Delegate) is to promote best practice in risk management, for financial institutions and clients alike. The head of the insurance section is encouraging insurers to take the lead – rather than the Superintendency – in the introduction of best practice for risk management through a focus on: (a) corporate practices, (b) clients' code of ethics and (c) consumer protection (Herrera and Miranda, 2004).

2.3 Research, information and supply of healthcare facilities

Another aspect of the enabling environment is that certain services need to be in place for the insurance industry to function properly, notably research findings, relevant information and a supply of adequate healthcare facilities.

Dealing with risks involves recognizing their sources and characteristics, e.g. whether they affect individuals in an unrelated or simultaneous manner. The most appropriate combination of risk-management strategies and arrangements in any given situation will depend on the type of risk and on the feasibility of the available instruments (Dixon et al., 2002). Sound information and statistical data may help in arguing the case for universal coverage and hence the need for microinsurance as one element in a larger social protection framework.

Moreover, the more information microinsurers have to determine appropriate prices and product features, the lower the premiums should be for poor policyholders. Statistical services for the insurance industry need resources and capacity. Such services, which could be supported by the state, would provide information that helps insurers in setting premiums and benefit packages. In health insurance, for example, this might include information on disease prevalence, the relative quality of facilities, and the recommended cost of different interventions. It can also facilitate the sharing of experiences and lessons learned among institutions and individuals involved in microinsurance and its promotion.

Another element is the supply of adequate healthcare facilities. In fact, the accessibility of existing health facilities and the quality of care they provide

Box 97

Health service providers and mutual health organizations (MHOs) in Mali

The most important partners of UTM (Union Technique de la Mutualité Malienne) are health service providers, which have a symbiotic relationship with the MHOs. Indeed, most MHOs are structured around a health centre *(aire de santé)* that delivers services to the people living within a certain geographical area. The healthcare providers benefit from the presence of MHOs as they ensure that the local population has the financial means to access services and many have often played a central role in the creation of new MHOs.

Source: Adapted from Fischer et al., 2006a.

represent key determining factors for any health insurance scheme's prospects of success *(see Box 97)*. Therefore, governments can support and promote the development of microinsurance by improving the availability, accessibility and quality of health services for all citizens in its primary healthcare centres and public hospitals (ILO, 2002c).

Healthcare providers are an essential element for the success of a health microinsurance scheme. Where the schemes can work in partnership with public providers – like UTM and UMSGF (Guinea) – they are better able to control costs because the public health providers often charge fixed fees. Public healthcare providers tend to be less expensive since their operations are partly or wholly subsidized by the state. If microinsurance schemes want to minimize claims costs, they need to find ways to work with the public health schemes better. A government supportive of microinsurance could certainly help in this regard. For example, in the case of Karuna Trust, a coordination committee has been formed to improve the quality of healthcare services, including representatives of the Ministry of Health and Family Welfare, as well as representatives of Karuna Trust and the insurance company. The coordination committee meets regularly to monitor the implementation of the insurance scheme.

2.4 Corruption and fraud

Corruption, if widespread, can present a significant barrier to the development of microinsurance and seriously hamper a scheme's chances of success. For instance, healthcare providers are supposed to depend upon formal payments and not demand under-the-table payments for admission to public facilities. Equally important in this context is fraud perpetrated by insureds who, for example, might claim fictitious healthcare costs, or by administrators who divert monies collected by the insurer (Weber, 2002). Governments can play an important role in fighting corruption and ensuring the credible and transparent functioning of healthcare delivery and financial settlement mechanisms (Ranson and Bennett, 2002).

Interestingly, the promotion of microinsurance schemes can also help to reduce fraud to some extent, at least in healthcare centres. For example, at UMSGF in Guinea, preliminary surveys conducted in the region showed that the average declared cost of hospitalization (medical or surgical) was GNF 80,000 (US$33) per stay, which was much higher than the official prices charged by health providers (which on average are GNF 20,000 (US$8.20)). Consequently, the microinsurance scheme chose to implement a third-party payment arrangement so that members did not have to pay for the treatment up front. By removing the financial exchanges between health staff and patients, it also reduces illegal practices such as over-charging.

3 Strengthening institutions

Besides creating an environment in which microinsurance providers and products might flourish, governments can also target interventions at an institution level to strengthen microinsurance providers and facilitate partnerships.

3.1 Networks and apex structures

For microinsurance to be successful, local, occupation-based units need to be linked to larger network structures to enhance representational functions and widen their risk pool. The experiences in Mali (UTM), Senegal (CRMST) and Guinea (UMSGF) demonstrate how a federated structure strengthens the system *(see Chapter 4.3)*. This critical linkage also provides a support structure for more professional operations, through internal control and performance-monitoring, advisory services, training, data banks, research facilities, sharing of lessons learned and relevant data, and liaising with external stakeholders. Networks also play a key role in starting up new schemes, and therefore expanding the availability of microinsurance and increasing the economies of scale.

Accordingly, governments should, whenever appropriate, encourage the creation of microinsurance associations or support existing ones. The financing of these support structures poses a major challenge, since many of them do not collect enough from their members to fully cover their costs. This may be an area where government subsidies could also be effective, as discussed in the following section. In addition, the government can also facilitate links to appropriate support organizations, including government agencies and local administrations, to foster mutually beneficial partnerships *(see Box 98)*.

Box 98 **Stewardship in Guinea-Bissau**

In Guinea-Bissau, the Ministry of Public Health has outlined specific responsibilities for village leaders regarding community-level health prepayment schemes. The policy framework allows a high degree of autonomy in scheme management, but holds the village accountable for various functions. For example, villages are free to decide the prepayment scheme's parameters (per capita, per adult or per household) and the timing of payments. Similarly, larger villages may create special health subcommittees to oversee the operations of village health centres.

The guidelines also specify the responsibility of villages. These include constructing health centres, for which the Ministry of Public Health provides some construction material, and ensuring that there are always adequate drug supplies. In this fashion, the partnership between the Ministry of Public Health and villages benefits from both the stewardship capabilities of the government in the form of guidelines and monitoring and from the local knowledge within villages.

Source: Adapted from Ranson and Bennett, 2002.

3.2 Link to donors and international funds

As described in Chapter 5.1, international assistance can help to promote microinsurance schemes, be it through direct cash transfers or through technical assistance. Yet microinsurance providers may not have the capacity, know-how and professional networks to establish contacts and negotiate terms of assistance with potential donors and/or international funds such as the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM) and the International Finance Facility (IFF), or under the innovative concept of a Global Social Trust (GST).[1] They rely on the government to play an intermediary role between external assistance and – ultimately – the target population *(see Box 99)*. In this context, the government's interest in microinsurance determines the volume and scope of external donor assistance, for example by setting priorities in bilateral and multilateral negotiations.

Box 99 **Facilitating links to UNDP in India**

The Indian Ministry of Health decided to set up pilot schemes in West Bengal and Karnataka to test community health financing options and to learn from the experiences. It agreed to work in partnership with established and successful NGOs; Karuna Trust was approached in 2001 on the recommendation of the Government of Karnataka. The scheme was designed to focus only on the public health centres. Karuna Trust's microinsurance operations started in 2002, with the NGO serving as the distribution agent for the government-owned National Insurance Company.

The main benefit of the insurance product is a per-diem payment to the insured when they are in hospital. Public facilities offer free treatment for those living under the poverty line or charge very modest fees for surgery

1 This concept is part of a wider campaign of the ILO to encourage countries to extend social security, and links developed and developing countries to enhance and extend social protection schemes in the latter *(see Box 14 in Chapter 1.3)*.

and hospitalization, outpatient services and (partly) drugs. The basic idea of Karuna Trust's insurance scheme is for the poor to use these free services instead of having to purchase them from other sources. The benefit package is intended to compensate for the weaknesses in the public healthcare infrastructure by compensating for wage loss. If the policyholder is hospitalized for more than 24 hours in a public health facility, Rs. 50 (US$1.10) is paid per day as compensation for wage loss, for a maximum of 30 days per year. All hospitalized persons are eligible.

To overcome the market's lack of knowledge of insurance, UNDP agreed to cover the premium costs for the first two years. A fully-subsidized premium might have made sale of the product easy, but in retrospect, it might not have been the best policy. It is difficult to persuade clients to pay for insurance that has been free of charge in the previous two years. Karuna Trust is now striving to overcome this problem.

Source: Adapted from Radermacher et al., 2005a.

3.3 Facilitating linkages with commercial insurers

In some countries, important microinsurance providers might include employers' and workers' organizations, service providers, professional associations, civil society groups and cooperatives. In particular, microfinance institutions that already have financial transactions with low-income households can play a key role in also providing insurance. All of these organizations may extend insurance to the poor, either on their own, in partnership with formal insurance companies, or within the framework of public-private partnerships.

As discussed in Chapter 4.2, the partner-agent model is a viable way to expand microinsurance. It links a commercial insurance company with an appropriate distribution channel to reach the poor, to the advantage of the insurer, the agent and the client. Given the mutually beneficial results of such a model, governments could help facilitate links between insurers and potential delivery agents.

Besides facilitating links, governments need to develop a legal framework conducive to such collaboration. For example, the Indian Insurance Regulatory and Development Authority (IRDA) has relaxed the licensing standards for microinsurance agents *(see Chapter 5.2)*. It is also important to recognize that such relationships are not always mutually beneficial, especially when the delivery agents do not have a strong grasp of insurance concepts and therefore do not negotiate good deals for their clients. Consequently, governments also must ensure that consumers' rights are respected and quality standards are met.

4 Providing financial assistance

Where microinsurance can be delivered purely on a market basis, financial support from the government is not needed. However, there are numerous situations in which purely market-driven microinsurance is not possible. For example, it can take several years for new insurance operations to be sustainable, except for the partner-agent model, which utilizes existing infrastructure. Market-based microinsurance is unlikely ever to reach the poorest and most destitute members of society, and therefore financial assistance might be required to extend the outreach of microinsurance schemes (i.e. serve poorer people). Subsidies may also be required for research and development, such as creating new products, enhancing benefits or experimenting with technology. Furthermore, apex structures may require financial assistance, at least until there are sufficient members to achieve economies of scale. Given the potential need for financial assistance, governments have to decide if they are going to make such investments, and if so, how they can be designed most effectively *(see Boxes 99 and 100)*.

4.1 Targeted transfer payments

To help deepen the penetration of microinsurance schemes, governments could include the provision of transfer payments to the poorest citizens unable to pay (in full or in part) for insurance (Dror and Preker, 2002). Targeted transfers to the poor have an important welfare impact. In this context, a political decision needs to be taken relating to the subsidy recipients: what are the selection criteria, and how can reliable statistical data be obtained on the poor and the poorest, their incomes and where they live?

In reality, many microinsurance operations depend on continuing access to some form of external subsidy. For example, VimoSEWA, which has been involved in microinsurance in India for more than a decade, experienced a loss ratio of 176 per cent in 2004 and a (projected) loss ratio of 154 per cent in 2005 based on the high claims for its health insurance benefits (the other product lines now provide a positive contribution).

As discussed in Chapter 5.1, subsidizing premiums may not be the most appropriate form of public intervention. Indeed, subsidizing health insurance schemes in places with restricted supply may lead healthcare providers to be less inclined to provide services to non-members, who are perceived as more likely to default on payment (Bennett, 2004).

Where the fiscal impact of subsidizing too many individuals would be unsustainable, the limited resources need to be targeted at the most vulnerable. In addition, most systems require some form of co-payment. The intention is to limit the cost to the public budget, but also to counteract opportunistic consumer behaviour (moral hazard). Another purpose of public transfer payments may be to close the recovery gap, which occurs when there is a systematic excess of expenditure on benefits over the income of a microinsurance unit.

Overall, based on a country's needs, administrative capacity, banking system and political priorities, transfer payments can be:

- given directly to individuals to acquire insurance;
- provided to support new schemes *(see Box 100)*;
- given to the social or community-financed microinsurance schemes (either regularly or during financial crises, both of which are likely to improve their financial viability);
- paid into a financial pool (through mechanisms including reinsurance);
- given to providers to cover investments or uninsurable services or
- provided in the form of tied transfers (direct and indirect), i.e. as subsidies that encourage the use of preventive care, primary care and essential pharmaceuticals.

In reality, a balanced mixture of these options has to be found. Considering the many market imperfections, it could be argued that subsidies would be used more efficiently if channelled through government providers or tied to certain goods or activities. At present, however, there is insufficient data to suggest that one type of subsidy is superior to others (Ranson and Bennett, 2002).

In providing subsidies for microinsurance, governments need to understand the effects on non-members as well as on members, and analyse whether overall governmental objectives are being optimally met given the chosen combinations. In general, it should be noted that subsidies do not guarantee social fairness or improved access for the poor – how the money for subsidies is raised and how it is spent are both important factors (Busse, 2002).

Box 100 **Subsidizing Yeshasvini Trust**

Yeshasvini Trust is designed as a self-funded insurance scheme, financed mainly through members' contributions, although it relied on additional subsidies to start. In the first two years of operation, the clients paid Rs. 60 (US$1.36) per person as a premium. For persons below the poverty line, the Government of Karnataka complemented the premium collected with an additional Rs. 30 per person (US$0.68). Altogether, the state government provided Rs. 45 million (US$1,022,727) in the first year and Rs. 35 million

(US$795,454) in the second year. However, the state's assistance goes beyond mere financial support.

Since Indian cooperatives are somewhat dependent on the government, the Department of Cooperatives can influence their involvement. The decision to allow members to simply deduct the insurance premium from their business income generated with the cooperative society was a major incentive for new members to join. The cooperatives are Yeshasvini's key to large numbers of insureds, covering 1.6 million members in the first year, and growing to 2.2 million in the second year. However, as the subsidies were phased out, the premium had to be increased to Rs. 120 (US$2.73), which significantly undermined renewals. In the third year, only 1.45 million members subscribed, illustrating the disadvantage of subsidizing the premiums.

Source: Adapted from Radermacher et al., 2005b.

4.2 Reinsurance

Reinsurance is another way in which public intervention could contribute to the viability of microinsurance schemes. As microinsurance is often used by a targeted population living in close proximity, the risk pool is not well diversified by location or occupation. Social reinsurance techniques could be used to improve the viability of small risk pools typical of informal microinsurance schemes (Dror and Preker, 2002).

However, just as the poor have no access to insurance, microinsurance providers typically have no access to reinsurance *(see Chapter 5.4)*. If the market-based reinsurance options of microinsurance schemes are insufficient, and in the absence of feasible reciprocal arrangements, the government may encourage and support the development of reinsurance mechanisms by either:

- reinsuring microinsurance schemes directly against certain covariate risks (the government may both establish a fund and make financial contributions to the pooled resources, i.e. a combination of reinsurance and subsidy) or
- subsidizing the premium microinsurers would have to pay for reinsurance.

Some observers argue that this approach is not sustainable, may create negative incentives and could perpetuate poor microinsurance designs (Newbrander and Brenzel, 2002). Given the limited practical experience in this area, it is not clear what financial resources, managerial capacity or institutional features a government would need to reinsure successfully. An alternative approach would be to facilitate links between microinsurers and government-sponsored reinsurers *(see Box 101)*.

Box 101

Africa Re

The African Reinsurance Corporation (Africa Re) was established in 1976 by the 36 member states of the Organization of African Unity with the aim of reducing the outflow of foreign exchange from the continent by retaining a substantial proportion of the reinsurance premiums generated. Its members are national governments, the private sector and the African Development Bank.

The purpose of Africa Re is to foster the development of the insurance and reinsurance industry in Africa, to promote the growth of the national, regional and sub-regional underwriting and retention capacities, and to support African economic development. To achieve its purpose, it:

- transacts reinsurance business through treaty and facultative cessions;
- creates and administers pools;
- assists in the establishment of national and regional insurance and reinsurance institutions;
- invests its funds in African countries in a manner that promotes the continent's development;
- provides technical assistance to African countries and promotes contacts and business cooperation among insurance and reinsurance institutions.

Africa Re is exempted from all taxation. It also can transfer its funds freely and has the freedom to open convertible bank accounts. These privileges have enabled it to grow without major regulatory hindrance. Africa Re's first experience in microinsurance was with the Kenyan MHO Mediplus and it now reinsures Microcare in Uganda.

Source: Adapted from Africa Re, 2003.

5 Concluding remarks

Microinsurance is not designed to become the main pillar of a country's social protection system, but it provides a complementary strategy that might be applied within a larger framework. As a first step, the government needs to facilitate a participatory process with key stakeholders to weigh the pros and cons of microinsurance and assess whether this approach would contribute to the country's overall social policy objectives. If it is decided to include it in a broader social protection framework, the government may facilitate the formulation of an explicit policy on microinsurance, consistent with all other relevant policies, which will be helpful in creating an environment conducive to building confidence in microinsurers.

Subsequently, governments can assist in the creation, replication and development of microinsurance through a variety of instruments. In this context, the government's first responsibility is to create a favourable climate for its development, beginning with regulatory adaptations that are directly and indirectly related to microinsurance. The creation of an enabling environment also involves the promotion of loss-prevention campaigns, cultivating an insurance culture, and the reduction or elimination of corruption and fraud. Other important instruments include research on microinsurance, as well as the dissemination of research findings and lessons learned.

The government's options for the active promotion of microinsurance include institutional support and financial assistance. Institutional support mainly involves the promotion of microinsurance networks and sound apex structures, linking microinsurance schemes to donors and international funds, and facilitating links between potential delivery agents and commercial insurers.

Financial support appears to be critical if governments wish to extend coverage to the poorest population groups. This could be provided through targeted transfer payments to ensure a high level of participation by the poorest and most vulnerable people, to improve the financial viability of microinsurance schemes, to cover certain socially important investments by providers or uninsurable services, or to encourage the use of preventive care, primary care and essential pharmaceuticals. Financial assistance also includes the government's role in reinsuring microinsurance providers against covariant risks.

The optimal combination of instruments will vary from one country to another, and within one country as it moves through different stages of development towards universal coverage.

5.4 The role of insurers and reinsurers in supporting insurance for the poor

David M. Dror and Thomas Wiechers

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In his address to the Microinsurance Conference sponsored by the Munich Re Foundation in October 2005, Hans-Jürgen Schinzler[1] offered his perspective on why commercial insurers and reinsurers were infrequent players in the low-income market: "Premium income is low, administrative costs are relatively high, and infrastructure for insurance is lacking; that's why commercial insurers have not taken more interest in this market."

This candid statement suggests that if premium income were high and administrative costs were relatively low, and the infrastructure for insurance were improved, commercial insurers and reinsurers would take more interest in this market. This raises two issues: first, what is the value proposition of commercial insurers and reinsurers for microinsurance schemes and the market of low-income clients? Secondly, as improvements on all three counts are more likely to evolve over time than to occur through a "big bang", what part(s) of this value proposition can insurers and reinsurers deliver during this evolutionary process? This chapter proposes a few answers to these questions.

The answers might differ according to the business model. This chapter focuses mainly on the role of insurers and reinsurers in supporting community-based insurance schemes that operate the mutual model, namely communities of individuals that bear the insurance risk and operate the scheme. The provision of much-needed reinsurance, training and technical support to these microinsurers is a key challenge for the development of microinsurance. This chapter refrains from dealing with microinsurance arrangements in which NGOs distribute insurance products but do not underwrite the risk (the partner-agent model), because these grassroots organizations are already associated with a specific commercial insurer. That insurer may or may not cede risks to reinsurance depending on ceding decisions that are not specific

1 Hans-Jürgen Schinzler is the Chairman of the Supervisory Board of Munich Re and Chairman of the Board of Trustees of the Munich Re Foundation.

to the agent. This chapter is inspired by the attitude that commercial insurers and reinsurers can capture viable business opportunities from a wider penetration of insurance in low-income settings, and that these opportunities justify the investment in microinsurance schemes because of their potential to serve as change agents in low-income communities.

1 The value proposition of reinsurance

The value proposition of reinsurance is its enhancement of primary insurers' ability to conduct their business by reducing the long-term cost of the underwritten risk. Reinsurance deals routinely with four main financial exposures: 1) capacity, 2) surplus relief, 3) catastrophes and 4) stabilization. Additionally, reinsurers provide ancillary services that complement the knowledge base of insurers. All of these services are relevant for microinsurers.

Every insurer (and microinsurers are no exception) can achieve the aim of reducing the cost of underwritten risks better when the number of clients increases. Taking on more insureds increases the predictability of business results, but it also means that for the overall quantum of claims and for catastrophic events the insurer becomes more exposed to the possibility – if only temporarily – that insurance losses could exceed premium income. Hence, insurers wishing to sell more insurance contracts than their own financial limits allow need to extend their financial **capacity**. Increasing capacity expands insurers' ability to underwrite a single large loss exposure *(large line capacity)* or many contracts in one line of business *(premium capacity)*. Incidentally, the additional capacity needed is not proportional, but is less as the insurer grows.

Premium capacity enhancement is probably more relevant in the context of microinsurers *(see Box 102)*. This can be achieved either through proportional reinsurance methods (e.g. "quota share" or "surplus") or through non-proportional reinsurance (e.g. applying a method called "risk of excess loss"). Since reinsurance is an expense, the microinsurer will wish to compare the alternatives for capital; those that can access cheaper capital will prefer to do so rather than opt for reinsurance, but in the absence of alternatives, reinsurance is useful.

Insurers collect premiums in advance, but know what portion of the premium they retain as earnings only retrospectively. Hence, at certain times, insurers hold premium income that they have not yet earned. Insurance regulations oblige insurers to keep surpluses reflecting premiums collected but not yet earned, which should equal the present value of future claims. However, microinsurers have to reserve all unearned premiums and at the same time bear all costs in the current year. This has a negative effect on the

Box 102

What do microinsurers get out of reinsurance?

Reinsurance gives microinsurers a discretionary budget and protection against insolvency.

Protection against insolvency is the fundamental advantage. The reinsurance contract guarantees that the reinsurer pays all costs above the reinsurance threshold, and thus the microinsurer's risk of failure is limited to below-threshold costs. The cost of the reinsurance premium must compare favourably with the safety margin that the microinsurer must maintain. The safety margin is proportional to the variance of the microinsurer's benefits. Studies have shown that reinsurance presents a clear advantage for microinsurers, particularly as their specific benefit package evolves in terms of diverse products and higher maxima (Dror et al., 2005a).[2]

Reinsurance can also relieve microinsurers of the need to maintain contingency reserves to cover higher-than-expected costs in bad years. These reserves are normally accumulated in good years. Obviously, reinsurance does not affect the probability of good years, but when it relieves microinsurers of the need to keep reserves, they can use surpluses accumulated in good years as **discretionary budgets** without taking any additional risk of insolvency.

The practical implications are that microinsurers measure the benefit they obtain according to two yardsticks: first, the larger the premium they need to pay to avoid failure and secure full solvency, the smaller the benefit; second, the larger the amount of discretionary budget they can obtain, the larger the benefit.

2 In Chapter 3.6, the opinion is presented that ceding risks to reinsurance is as much a management decision as the result of a set of calculations of the primary insurer's exposure. The authors of that chapter hold the view that, in certain circumstances, the choice may be subject to the exercise of judgment by management. This is particularly valid when the underlying terms of insurance are less than optimal due to extreme limitations on benefits. For example, when the expected incidence of an event is high, its predictability will also be high, and consequently its variance will be low. Variance also decreases when the benefit package includes few uniform benefit types and low maximum benefit amounts, because claims then become more predictable. There is less need for reinsurance in such cases, because the incidence of claims and amounts for claims submitted is reduced to a degree that renders fluctuations low and the financial protection of insurance less relevant.

Experience with microinsurance suggests that for many life products, claim amounts are constant due to the uniform coverage; therefore, the random variable "aggregate claim variance" would tend toward zero. For credit life, there is some variance in the outstanding loan amounts, so there is a contribution to aggregate claims variance. For health, if there is a low benefit maximum (as is frequent at present in health microinsurance schemes), contribution to aggregate claims variance would be small; in fact, the higher the number of clients reaching the maximum, the lower the contribution to variance.

Finally, it should be borne in mind that the reinsurance programme comes at a cost; thus, over-insurance can be as detrimental to the overall cost-benefit situation of the organization as under-insurance. Catastrophe reinsurance is one form of reinsurance that should not cost much and would be useful in most situations. The other functions of reinsurance are usually not used by microinsurance schemes.

microinsurer's results and may cause liquidity problems. Buying quota-share reinsurance would enable the microinsurer to reduce the unearned premium reserve; additionally, the microinsurer would receive a commission from the reinsurer, which would contribute to covering the costs and improving results. This is amplified when microinsurers experience rapid growth. Fledgling insurers may also have difficulty managing the surplus account, particularly early in financial periods, and when the client-base increases rapidly. Some insurers find it easier to meet this surplus requirement by buying **surplus relief**, also known as financing, from a reinsurer.

Insurers accept the risks of their insureds on the basis of statistical assumptions about the probability and variance of risk occurrence. However, every insurer also knows that there is a small possibility that the company's survival might be endangered if worst-case scenarios occur. **Catastrophe protection** is the preventive measure taken by insurers to spread exposure to fundamental risks that can endanger the company's survival. The prevalent reinsurance methods that offer catastrophe protection are catastrophe per occurrence excess-of-loss and aggregate (stop) excess-of-loss, both non-proportional methods of reinsurance. There seems to be broad consensus that catastrophe reinsurance is indispensable for microinsurers. Low volumes should not be a limiting factor for the provision of this reinsurance. In fact, in a historical perspective, one of the main tasks of professional reinsurers has always been to help small insurance companies to remove their existential risk first. Microinsurance companies should be able to access the same service.

Finally, insurers wishing to operate within a predictable and stable environment may wish to keep loss ratios within defined tolerance levels and/or ensure steady profits. This **stabilization** (or stable loss experience) can be achieved through reinsurance (but, of course, reinsurance is not a subsidy, and microinsurers will have to pay in good years for what they receive as compensation in bad ones). Most reinsurance methods can be used for this purpose.

In addition to the four main financial functions described above, reinsurers often sell expertise in insurance mathematics and statistical information on the market. Reinsurers can offer **underwriting expertise** because their client-base includes more than one insurer in the same or similar markets. This superior access to information gives reinsurers a relative advantage in preparing statistical estimates of risks and costs. In addition, reinsurers specialize in the expertise that is required for the insurer to decide which risks to cede to reinsurance and which risks to retain. The caveat to this general description is that, at present, reinsurers do not offer much expertise to microinsurers.

Reinsurers are also instrumental in cases where the regulations require insurers to reinsure certain risks. Reinsurance that is prescribed by regulations rather than by autonomous cession decisions of the insurer is essential for insurers to meet regulatory requirements. This is why it is often called **compliance assistance.**

Finally, insurers who decide to withdraw from an entire class, line, territory or book of business may cede the entire portfolio to reinsurance, although in reality it is more likely to see a competing insurer take the market share over. This enables insurers to continue to service clients without breach of contract, while no longer assuming any financial exposure linked to this portfolio. This is called **portfolio insurance**.

The focus of this chapter is on the contribution of insurers and reinsurers to microinsurers. The chapter first considers the evidence from the case studies regarding relationships between insurers and reinsurers with microinsurance schemes, and then describes options to expand the range of opportunities for microinsurers to benefit from the value proposition of reinsurers.

2 Involvement of commercial insurers and reinsurers in microinsurance

The case studies listed in Appendix 1 provide several examples of cooperation between commercial (re)insurance companies and microinsurance organizations, as described below.

1. The relationship between Spandana, an Indian microfinance institution, and the Life Insurance Corporation of India (LIC) was short-lived because LIC's products and processes did not match the priorities of the target population. Instead, Spandana chose to design its own life insurance product based on the mortality data it had obtained from LIC. Interestingly, Spandana found that its own product generated excessive surplus, using the same mortality rates and the same premium as LIC had. Spandana, therefore, added more benefits without increasing the premium. Providing in-house insurance enabled significant improvements in claims settlement as well.

2. Spandana could not obtain reinsurance because it is not a licensed insurance institution. It chose to minimize the threat of covariant risk in two ways: excluding risks that could cause extremely high claims (e.g. deaths and damage caused by epidemics or natural disasters) and limiting benefits to a relatively low level. These measures reduced the attractiveness of the product and its usefulness for the insured; this loss of usefulness could have been avoided by reinsurance.

3. VimoSEWA (India) has an agreement with two commercial insurers, Aviva and ICICI Lombard, under which it maintains responsibility for distribution, premium collection, record-keeping and claims payment. The commercial insurers set the premium and underwrite the risks. Responsibility for product design is shared through an informal consultative process between the insurers and VimoSEWA. This division of labour leaves VimoSEWA with certain functions that are not typically carried out by insurance agents. Additionally, VimoSEWA's responsibility for keeping records and settling claims gives it access to more information than the typical agent would have. With some underwriting assistance, VimoSEWA could exercise more control over the pricing of the insurance products, with a view to verifying that the profit margins of the insurers are fair.

4. In 2001, Shepherd (India) entered a two-year partner-agent contract with insurance companies HDFC-Chubb and ICICI Prudential. Assuming that the low premium levels did not justify investment or involvement in this community, the insurance companies kept their contacts to a minimum. However, claims processing, which was run from the head offices of the companies, brought to light that the insurers had gained insufficient understanding of the conditions and requirements of the insured: the procedures were too slow and too complicated for the policyholders and thus complaints and dissatisfaction followed. To remedy this unsatisfactory situation, Shepherd moved its commercial partnership to LIC. Representatives of LIC visited microinsurance policyholders repeatedly and discussed insurance products and processes. This greatly enhanced LIC's knowledge of the market and created a higher level of acceptance and understanding of insurance among the community members. It also led to an agreement under which the role of Shepherd was enlarged to pay out claims in advance and get reimbursement from LIC. For this purpose, LIC provides Shepherd with a management information system that enables it to collect and analyse data more efficiently and reliably.

5. For health insurance, Shepherd has a second insurance partner, United India Insurance Company (UIIC). The relationship with UIIC is structured using a similar approach: Shepherd ensured that UIIC representatives met prospective clients before entering the partnership. During the meetings, UIIC gathered information on healthcare expenditure to be covered under the policy, the premiums members were willing to pay and the benefits that clients would expect or prefer to be included in the package. UIIC designed the UniMicro policy based on this information. However, certain decisions on exclusions from the policy based on the age of the insured or membership

in Shepherd were entrusted to the microinsurance members, thus enhancing the relevance of the qualifying conditions and the community's ownership for the scheme. Additionally, UIIC and Shepherd established an "Insurance Review Committee", which is composed of representatives from UIIC, Shepherd and the insureds to monitor underwriting and claims processing practices, respond to complaints and solve problems.

6. ASA in India is another MFI that assumed an intermediary role between a commercial insurer and the clients. ASA moved its commercial relationship from UIIC to LIC in response to a supposedly better offer. However, it soon became clear that the move was not entirely without drawbacks. For instance, LIC did not cover death during childbirth, suicide or death caused by snakebite or drowning. LIC asserted that these exclusions were standard in the insurance industry, but this explanation did not satisfy ASA's clients who knew that these benefits had previously been covered. Additionally, it took LIC a long time to process claims and it paid them by crossed cheque, which was of no use to many policyholders who did not have a bank account. In general, the daily management of the partnership with LIC became cumbersome and very bureaucratic. Hence, the expectation that the move to LIC would give ASA members a better deal was not fulfilled, due in part to insufficient interaction between the insurer and the community and possibly also to inflexibility in handling clients' dissatisfaction.

7. In 2002, the Indian Insurance Regulatory and Development Authority (IRDA) issued regulations requiring all insurance companies to transact a certain percentage of their business with poor and rural clients. These regulations define microinsurance as traits of the products, rather than recognizing the unique role of non-profit organizations such as ASA in the business process. Unfortunately, the regulations limit the role of these organizations to serving as agents of commercial insurers. Using its experience in dealing with insurance companies, and as it could offer a large client-base, ASA solicited bids from insurance companies willing to enter a partnership. The main criterion ASA applied when reviewing the bids was that the companies should agree to pay benefits directly to ASA and allow it to verify claims. Eventually, ASA chose to partner with three insurance companies (AMP-Sanmar, Bajaj-Allianz and Max New York) on equal terms and with identical products. ASA's relationship with the insurers was driven in part by the fact that they could purchase reinsurance, a condition ASA considered essential, but which is available in India only to commercial insurance companies.

8. In 1997, AIG Uganda entered the low-income market with purely commercial intentions to establish profitable operations. Today, AIG Uganda provides accidental death and disability coverage to more than 1.6 million persons in East Africa through 26 MFIs. AIG Uganda operated without competitors in the market and its success in market penetration has been due in part also to specialized AIG staff agents who are actively involved in information dissemination. These agents receive commissions from AIG Uganda based on the volume of business. Thus, the agents have an interest in generating more business, and as they are responsible for certain operational aspects, they have an interest in efficiency as well. The agents provide an initial briefing to the MFI loan officers appointed to sell the insurance product to the MFI's clients. However, the loan officers generally have only limited knowledge and understanding of the product and do not need to meet any formal training requirements. The training they receive focuses on premium collection and an initial check of claim documents. Incidentally, AIG does not feel it requires reinsurance for this book of business.

9. The ALMAO scheme (Sri Lanka) has had reinsurance arrangements since 1992. First, it was reinsured with CUNA Mutual and then with the state-owned SLIC (privatized in 2003) on a quota share basis. After ALMAO's registration as a commercial company in 2002, it reinsured its risk with NTUC Income (Singapore). These treaties were concluded on a commercial basis.

10. The Yasiru scheme (Sri Lanka), registered in 2000 and collaborates with the Rabobank Group (Netherlands). The collaboration includes financial support through the Rabobank Foundation, the provision of technical know-how and the necessary hardware, software and training. Rabobank's reinsurance subsidiary, Interpolis N.V., has provided long-term reinsurance and technical assistance to Yasiru on concessionary terms. The cover offered by Interpolis is a 100 per cent quota share with a maximum of LKR 120,000 (US$1,200) per risk. The reinsurance premium payable to Interpolis for the annual contract is 20 per cent of the gross premium income of Yasiru. In reality, under the concessionary arrangement, Yasiru retains 95 per cent of the reinsurance premium as a no-claims commission, so that in fact Yasiru pays only 1 per cent of gross premiums to Interpolis for reinsurance. Needless to say, this kind of concessionary reinsurance agreement is usually unavailable in the market. In 2005, the partners started to align the reinsurance agreement with more market-based terms, but the arrangement is still favourable for Yasiru.

11. The International Cooperative and Mutual Insurance Federation (ICMIF)[3] used to provide assistance and reinsurance intermediation to its members around the world. The mission of ICMIF Reinsurance Services (RS) is to encourage reinsurance placements between members of ICMIF, to advise members on their reinsurance requirements and assist them in obtaining suitable cover with secure reinsurers within or outside ICMIF. One of the main methods by which ICMIF promotes co-operation and understanding in reinsurance is its Meeting of Reinsurance Officials (MORO), held every two years for reinsurance managers from members around the world. Such worldwide contacts give ICMIF's members an advantage in facilitating treaty placement. RS also provides reinsurance training, with two interactive business simulations: 1) *ReAction* models the reinsurance negotiation process between insurers and reinsurers, and claims success in team building, decision-making, communication and negotiation; and 2) *Morotania* combines a financial planning model with an interactive map to simulate challenges encountered by new, developing companies. Finally, ICMIF has produced a practical guide on establishing a suitable reinsurance programme.

12. ICMIF supported the Columna scheme (Guatemala) in obtaining reinsurance. The primary goal was to achieve long-term stability through reinsurance of the whole portfolio (including microinsurance), while keeping the reinsurance premiums to a minimum. Towards the end of each year, ICMIF and Columna prepare information and statistical data required to develop a reinsurance programme for the following year.

13. La Equidad Seguros (Colombia), which has reinsurance for its non-micro policies, wanted to obtain reinsurance for its microinsurance business. This was impossible because its total financial risk was lower than the deductible determined by the reinsurance provider. Therefore, La Equidad Seguros could not obtain reinsurance for policies below CoP 10 million (US$4,100). Reinsurance is only provided for catastrophe cases exceeding CoP 150 million.

14. Delta Life (Bangladesh) experienced the same problem. As it is registered as a commercial insurance company, it has reinsurance treaties with SwissRe and Munich Re. However, these treaties do not include Delta's microinsurance businesses, because the deductible required is higher than the total amount of microinsurance risk. The high minimum premium reflects the low benefit amount and large number of insureds, and the concern of the reinsurer that many of the members will claim the maximum benefit.

3 Information on ICMIF has been obtained from its website: www.icmif.org

In conclusion, the case studies contain few references to symbiotic business relationships between microinsurers and commercial (re)insurers. Setting aside for a moment the "partner-agent" relationship *(which is covered in Chapter 4.2)*, some of the examples can be defined as simplified versions of underwriting assistance. There are very few examples of reinsurance being used to prevent catastrophes. Interpolis Re, through its cooperation with its microinsurer partner, Yasiru, provides the only adaptation of the professional *modus operandi* to the specific prevailing conditions.

3 What part of this value proposition can insurers and reinsurers deliver?

The few timid contacts between commercial players and microinsurers are based on a relatively rigid scope of products. There are a few examples where the negotiations between microinsurer and commercial insurer have led to a slightly better fit between what each partner expects from the relationship. However, most insurers and reinsurers do not have a clear strategy for servicing microinsurers, and therefore do not invest in acquiring knowledge of how to do it.

Microinsurers need large insurers only to the extent that those insurers enable them to a) sell a variety of products at low premiums and b) remain solvent. The first issue is directly linked to the fact that if the low-net-worth market is to pay a premium, insurers must ensure that they sell relevant insurance products at affordable prices. The second issue is linked to the legitimate concern of poor people that the companies they deal with will be there when the time comes for them to pay benefits. Large insurers seem to underestimate the long-term potential of this market segment and their need to work closely with a local partner if they are to conclude many small transactions. The evolution of business relationships between commercial reinsurance companies and microinsurers is largely contingent on delivering more variety at a lower per-contract cost.

What can insurers and reinsurers actually do now? They can make efforts to develop innovative ways of selling their services to the low-income market. The entry of insurers and reinsurers into business with microinsurers can be seen as an investment aimed at developing a business model for selling insurance in small portions so that these sales can aggregate to significant financial volume over time. This would be the equivalent of what was done in mobile phone business: the huge upfront investments in infrastructure are justified by large market penetration in the low-income segment.

Insurers and reinsurers can also provide services to microinsurers. For instance, when a microinsurance scheme wishes to increase its client base, it needs the financial capacity to underwrite many contracts in one line of business (premium capacity). Reinsurance could easily satisfy this need with existing tools, although it may have to content itself with lower margins. The barrier is neither conceptual nor technical, but created by an unwillingness to underwrite the small volume of business. The anecdotes that some microinsurance schemes have not been able to obtain reinsurance because the total value of their portfolios was lower than the reinsurer's deductible are indicative of the gap between the two parties.

There is at least one example showing that such business relations are possible: the Interpolis Re model. This Dutch reinsurer has "adopted" a Sri Lankan microinsurance scheme and initially provided technical assistance to help the microinsurer to quantify and present its underwriting exposure. Interpolis also agreed to reinsure some of the risk, but with a higher than average "no claims commission" as a means of reducing the reinsurance premium to the bare minimum. It could be said that Interpolis absorbs excess risk of Yasiru, if it were to occur, with caps that are relatively low for the large reinsurer, but sufficiently large for the microinsurer.

Although details of how much this "hand-holding" costs are not available, it seems safe to assume that the amounts in question are probably quite modest. The arrangement can certainly not be considered as charity, as the main focus is on establishing the correct contractual basis for a business relationship between the microinsurance scheme and the reinsurer. This is why one can view the cost of the "hand-holding" as an investment in helping the micro scheme to professionalize its activity as an insurer. This creates a basis for the enlargement of commercial relationships (including a less concessionary reinsurance premium) when the revenue stream and the knowledge base of the micro scheme allow such a move. It is indeed noteworthy that, from inception, the relationship between Interpolis and Yasiru has been based on remunerated (but probably not for-profit) services.

Can this arrangement be scaled up to many more microinsurance units? Such a development is contingent on structuring the transition from privileged relationships to normal commercial interactions. Some hold the view that it is risky to start with subsidized reinsurance premiums because clients may resist premium increases later and because it deters insurers and reinsurers from entering such markets. Hence, it is necessary to consider ways in which the insurance and reinsurance industry can widely offer its value proposition to microinsurance schemes. Two courses of action seem particularly opportune:

1. Focus on building up the capacity of microinsurance schemes to assume a growing range of insurance activities, rather than limiting micro schemes to

the role of agents. This is particularly important in product types where the potential for conflict of interest between the agent (representing the insurance underwriter) and the microinsurance scheme (representing the clients) is acute.

2. Create a reinsurance facility that would service this market segment until it becomes sufficiently attractive for commercial insurers to manifest more interest, possibly with some public funding.

3.1 Capacity-building as a first step to professionalizing microinsurance operations

It is estimated that some 35 to 40 million persons are covered by microinsurance schemes worldwide, of which more than five million are covered by health microinsurance schemes in India alone (ILO/STEP, 2005a). There is a growing body of evidence that microinsurance schemes make a difference in improving the financial protection of clients through various types of insurance (e.g. Dercon, 2005; Morduch, 2006; Jütting, 2003; Dror/Soriano et al., 2005) and it is widely claimed that an information-intensive industry such as insurance cannot find sufficient technical knowledge at the community level (e.g. Brown et al., 2000; Schinzler, 2005). However, insurance must rely on comprehensive and solid data and sound underwriting expertise to be financially sustainable. Developing appropriate data collection processes and training the management is one of the key steps microinsurance providers must take to grow and attract commercial insurance and reinsurance. Existing training facilities are unable to rise to the challenge of training sufficient numbers of people to carry out technical roles. Consequently, the logical response is to create the institutional structure for more, better and faster training in skills directly related to the operations of microinsurance schemes.

The insurance industry, which is likely to benefit from such training, could make a tangible contribution to the development of training programmes, both in cash and in kind. Since public-private partnerships (PPP) are the preferred modus operandi of many development agencies, the insurance industry could enter into a PPP for capacity-building. The funds that the insurance industry would need to devote are very modest and can be complemented by funds from public sources. In addition, such modest contributions can facilitate the involvement of the industry in curriculum decisions and in supplying trainers.

The important role of commercial insurers and reinsurers today, and their strong interest in the development of the insurance sector notably at the micro level, implies carrying a share of the responsibility to create the missing "industrial infrastructure" for (micro)insurance, which they can assume by supporting institutionalization of training structures. It is noteworthy that for the time being, *there is not a single dedicated institute anywhere in the world that focuses on capacity-building for microinsurance operations*. There are a few initiatives to create resource centres for microinsurance;[4] however, none has established a systematic approach to rolling out capacity-building at the grassroots level. Therefore, establishing a "Microinsurance Academy" that would focus on such capacity-building in domain knowledge is neither premature, nor a luxury, nor the sole responsibility of public authorities or the microinsurance schemes themselves.

Microinsurance requires different products and a different business model, which places some of the essential functions of the insurance value-chain with the community.[5] Several examples from the case studies suggest the need to revise the classical training of insurance agents because the role of microinsurance schemes – even under the partner/agent model – goes beyond the classical agency role. For example, microinsurers sometimes operate front-office functions; communities sometimes play a pivotal role in securing broad-based affiliation and renewal, thus reducing the risks of adverse selection and free-riding, and communities can reduce moral hazard by using information freely available within the community to monitor utilization. Other roles for the community include involving the clients in benefit-package design and encouraging a higher willingness to pay through a better fit between products and client needs.

Creating one or more dedicated competence centres for microinsurance fits in with the wider development agenda that considers insurance and microinsurance not as ends in themselves but as vehicles for achieving higher socio-economic development goals. The Millennium Development Goals (MDGs) enjoy the widest recognition; they focus on poverty reduction and prioritize several main areas, of which health is one. It has been recognized that attaining the health-related MDGs requires new ideas to overcome systems constraints to delivering effective intervention.[6] One of the key issues

4 For example, USAID has funded an initiative to create the MIRC (Micro Insurance Resource Centre) in India; a similar effort is being pursued by CARE India in collaboration with Bajaj Allianz. The Canadian Cooperative Association has also created a resource centre in the Philippines and in West Africa there are periodic meetings, organized by ILO-STEP, for mutual health insurance schemes to exchange information.

5 Several studies have concluded that the involvement of the community in the management of the microinsurance scheme is a critical factor for its success. For an overview of these studies see Jakab and Krishnan, 2004.

is health financing, where the divide between knowledge and production (the "know-do" gap) is still wide at all levels, but particularly large at the grassroots level, hence the need to offer training so that community members can carry out the business processes and add value to outcomes. In this context, the contribution of commercial insurers and reinsurers to the MDGs could well be made tangible by their support for the establishment or an institutional training structure.

3.2 Creating reinsurance capacity that is accessible to microinsurance units

As stated earlier, reinsurance offers insurance companies many advantages, including stabilization of losses and surplus relief. Indeed, it is impossible to imagine today's insurance industry foregoing its commercial relations with reinsurers. The situation of microinsurers is, however, completely different. Although these small schemes would have similar advantages if they could access reinsurance, the empirical experience suggests that they are usually unable to buy the full range of reinsurance services. The obstacles seem to be on the supply and regulatory side, rather than on the demand side.

At the Munich Re Foundation microinsurance conference, a proposal was tabled for reinsurers to create a "Joint Reinsurance Underwriting Association" or a syndicate to provide reinsurance to microinsurance schemes to reduce risk exposure while spreading the cost of developing the market. The objective is to enable microinsurers to buy reinsurance, while limiting the effort of each participating commercial reinsurer. This syndicate would have to overcome some definition problems, including a decision about which kinds of risks to accept, whether to operate worldwide or only within the boundaries of single countries, and so on. It would also have to deal with a microinsurance industry that is not always well managed. Most critically, such a syndicate would have to overcome a mental barrier that seems to impede cooperation between large reinsurers, who usually prefer to operate individually and have sufficient financial and technical capacity to do so. However, a syndicated facility by several reinsurers who see the merit of institutionalizing the access of microinsurers to reinsurance would fill part of the "missing industrial infrastructure".

Another concept for the supply of reinsurance for micro schemes is the "social reinsurance" model, which emphasizes the need to reduce the exposure of microinsurance to claims fluctuations *(see Box 103)*. The conceptual

6 *Mexico Statement on Health Research* issued by the Ministerial Summit on Health Research, Mexico, November 2004. The World Health Assembly adopted the Ministerial Statement as resolution WHA 58.34 in May 2005, following which WHO is now setting up a programme to close the "knowledge gap".

analysis reported in the Social Re book (Dror and Preker, 2002) shows a way to remedy inherent vulnerabilities of microinsurance schemes operating on their own by establishing a generalized ceding limit (or threshold) identical to the long-term average cost of claims and passing on to the social reinsurer the risk of outlier claims. This enables microinsurers to remain financially viable and to calculate their premiums more accurately, while reducing their need to maintain capital for contingencies.

Box 103

A short summary of the social reinsurance model

The "social reinsurance" model offers a way to quantify microinsurers' vulnerability and to examine the effectiveness of reinsurance as a remedy. The model deals only with considerations that can be predicted by the application of statistical laws. The focus is on the effect of fluctuations in microinsurers' and reinsurer's total benefit expenditure. Variance in total cost can stem from a small claim load or from a large variation in unit cost. A small claim load is likely to occur either when the group is very small or when the insured event is very rare.

The Social Re model is suited to deal with these circumstances. It can be applied when the standard deviation (SD) of each microinsurer's total benefit cost is known. The reinsurer's success is highly sensitive to the accuracy of this SD; a 20 per cent error in SD value can signify the difference between the reinsurer's long-term solvency and bankruptcy.

The SD can be calculated only when the risk probability is known. In reality, the estimate of risk is often unreliable. Even when risk probability is known, the reinsurer is still affected by the size of the pool (or the number of reinsured microinsurers) and the heterogeneity of risk profiles. The larger the pool, the better the reinsurer can spread risk and reduce the variations in its business outcome and premiums. When the pool is small, the adverse effect of heterogeneous risk profiles requires a higher premium for stabilization.

When the reinsurance contract reduces the resources needed to secure at least the same level of solvency for a defined level of expenditure, it becomes an interesting option. This value proposition calls for a comparison between two quantities: the cost of *a safety margin* over and above the mean cost of benefits[7] and *the reinsurance premium*. Reinsurance is advantageous when the reinsurance premium is cheaper than the safety margin (assuming that the reinsurance threshold is equal to the mean benefits).

7 Bearing in mind that 100 per cent survival (without reinsurance) can be guaranteed only when resources to cover the worst-case scenario are available at the beginning of the period, a microinsurer without reinsurance needs resources equal to its mean benefits, plus a safety margin proportional to the variance of its benefits.

The comparison between the two values is complicated because the microinsurer's expenses fluctuate, and thus the maximum capitalization needed is unknown. Since expenditure fluctuates, the microinsurer will need less than the maximum in some years and is challenged to operate with as little up-front capital retention as possible, without increasing the insolvency rate. When reinsurance is considered, the cost of the reinsurance premium plus the microinsurer's maximum liability (defined as the *reinsurance threshold*) ceases to be an estimate as it is defined in the reinsurance treaty. Hence, reinsurance also reduces the uncertainty for the microinsurer.

The reinsurance premium has to cover the reinsurer's solvency. The solvency rate of the reinsurer is assumed to be 95 per cent. The number of microinsurers in the pool and each pooled microinsurer's risk profile determine the reinsurer's solvency. A simplified example shows that each microinsurer needs 10 monetary units at the beginning of each period to ensure its solvency without reinsurance, but only half that amount of capital with reinsurance, when 30 identical microinsurers sign identical reinsurance contracts for one year.

Source: Adapted from Dror and Preker, 2002.

The social reinsurance model distinguishes itself from commercial models by the specific focus on the needs of microinsurers, including the option that microinsurance units can enjoy discretionary budgets for development of new benefits in years when claims are below the estimated long-term average. This feature is designed to motivate communities to reduce moral hazard and free-riding, as these phenomena counteract the interests of the insured.

Additionally, the link between social reinsurance and microinsurers includes a systematic access to technical assistance, including benefit-package design, claims processing, IT systems, etc. Since the success of social reinsurance depends on effective pooling of multiple micro schemes, it is necessary to develop and implement a standardized data-collection system and a data-transfer protocol.

Implementation of the social reinsurance concept can occur through multiple options of incorporation. It is essential that a way is developed for unincorporated microinsurance schemes to enter into reinsurance relationships so that they can offer viable protection to the low-income market. The mission of the social reinsurer is to serve as the conduit between microinsurers and the commercial (re)insurers.

4 Recommendations

4.1 Partnership-favouring considerations

Partnerships usually succeed when both sides consider the relationship to be beneficial. Many insurers and reinsurers in developed countries operate increasingly in stagnating markets, with much competition and shrinking profits. At the same time, new markets in emerging countries (e.g. China, India and South Africa) provide large untapped business opportunities. Some of these opportunities extend to high-net-worth individuals and companies, but the vast majority of the untapped client base is the low-income segment.

The experience of microcredit and mobile phones has demonstrated that financial services for low-income groups can operate profitably. The same applies to insurance; there are no inherent reasons why insurance for low-income persons should be unattractive commercially. However, success of insurance at "the bottom of the pyramid" requires the industry to adapt to the clientele, rather than expecting clients to adapt to the vendor. Adaptation in this context would refer mainly to front-office and back-office administrative practices, rather than to core business considerations such as diversification of risks over large risk pools and over long periods of time. The lower cost of computers, software and means of communication and better educational facilities make it feasible today to operate in low-income and rural population segments.

Insurers and reinsurers may find in microinsurers capable partners that simplify the process of entering the low-income market, and thus change the business paradigm of insurance. Businesses that depend on access to large numbers of clients for their success can no longer adopt a strategy of ignoring the majority of the world's population.

Table 49 summarizes both internal factors (those arising from internal and organizational constraints) and external factors (demanded by external stakeholders and regulations) that favour partnerships for insurers and reinsurers.

At the other end of the partnership continuum, microinsurance schemes are also subject to internal and external pressures that favour partnerships with insurers and reinsurers. These factors do not apply uniformly everywhere, but they are given here *(Table 50)* to facilitate the understanding that partnerships are win-win business propositions in the long term.

Table 49 **Partnership factors for an insurance or reinsurance company**

Internal factors	*External factors*
– Corporate social responsibility	– Growing competition in traditional markets
– Risk diversification	– Shrinking margins in traditional markets
– Securing or growing revenue	– Regulatory requirements
– Push for new markets and innovative products	– Political and activist pressure
	– Liberalization of previously closed markets

Table 50 **Partnership factors for a microinsurance institution**

Internal factors	*External factors*
– Access to professional management practices	– Regulatory pressure to institutionalize or collaborate with a registered insurance
– Access to financial resources	– Documentation requirements by donors and/or government
– Implementation of standard insurance practices	
– Support in expanding products and coverage	
– Risk diversification or need to acquire reinsurance	

4.2 Establishing the partnership

Partnerships between microinsurance schemes and commercial insurers or reinsurers will occur when both sides agree to adjust and adapt to each other. The insurance products must be of interest to and affordable for the low-income market, and at the same time commercially viable. The viability of products is determined by an adequate fit between premiums and benefits, independently of business volumes. At the same time, also independently of business volumes, insurers and reinsurers must adapt their products to the needs and business model of microinsurers. At the present "embryonic stage", business development entails on the one hand looking for solutions which enable microinsurers to operate profitably, and on the other hand recognizing that profitability may be compromised by start-up costs.

Reinsurance companies can help design products. Insurers can help commercialize products. However, neither insurers nor reinsurers are best placed to organize training activities, even though they can support this crucial activity financially and by allocating experts to training. It is tempting to suggest that the most promising approach to partnerships is to involve microinsurer, insurer and reinsurer from the beginning. However, the case studies do not offer much evidence to support that this suggestion has been followed very frequently. Instead, the more consistent conclusion from the experiences reported elsewhere in this book is that commercial insurers and reinsurers must acknowledge that microinsurers are not simply scaled-down versions of insurance agents. The different economic and social situation of low-income groups requires a critical review and adaptation of the processes applied and the products offered in the traditional insurance market. Secondly, microinsurers must do more than just expect others to adapt to their unique situation; they must take the lead in developing innovative approaches to tap what their clients want in product design, insurance practices and loading levels for administrative and capital costs. The evidence provided by the case studies suggests that the prevalent practices of commercial insurers or reinsurance providers are not in line with the needs of most microinsurers that underwrite risks.

The partnerships which enable microinsurers to obtain adequate domain knowledge and the necessary access to information, capital, hardware and software will, for the foreseeable future, constitute as much a means of collaboration to create the "industrial infrastructure" as pure commercial transactions involving the transfer of risk. It will take more than merely "win-win potential" to see the partnerships take hold on the ground.

5 Conclusion

Insurers and reinsurers have a vital role to play in the success of microinsurance schemes. They can make a concrete contribution to implementing business processes that reduce the long-term cost of underwriting risk for low-income persons. Partnerships inspired by this motive can be of interest for both sides, as the commercial partners are best placed to adapt tried-and-tested methods of reinsurance and other modes of risk transfer, and microinsurers can expand the financial capacity of their schemes and underwrite more and larger risks. Successful partnerships would bring more business for both sides.

Reinsurance offers microinsurers an untapped alternative way of enlarging their capacity to become the leading underwriters of sustainable insurance services for the poor. Microinsurance schemes are in most cases operated by people who do not have much expertise or experience in insurance. The leaders of microinsurance schemes are not necessarily aware of the services of reinsurance, including assistance in underwriting mathematics and statistics, or the use of tools for product design, administration systems or efficient marketing. In short, the leaders of microinsurance schemes are often unaware of the benefits of reinsurance.

The case studies have identified several noteworthy examples of cooperation. However, only very few are modelled as reinsurance partnerships. Thus, the challenge is to develop a reinsurance model for microinsurance that is commercially viable and replicable. The potential of the market, especially in emerging economies with large uninsured low-income populations, justifies efforts to develop such a model.

Besides the cooperation between corporate and not-for-profit institutions, there is ample room for public-private partnerships, which could provide the platform for cooperation between public institutions or development agencies and industry-wide corporate bodies. However, whatever forms the partnerships take, the commercial partners should utilize their expertise in insurance mathematics, risk diversification and product design, and microinsurers must retain the lead in adapting the business to the reality of the clientele at community level.

Commercial insurers and reinsurers tend to underestimate the peculiarities of the microinsurance market. It is important to recall that microinsurance developed mainly because of the short supply of adequate products from commercial insurers. Therefore, cooperation could proceed when the commercial partners show more willingness to review their products and administrative processes. One must bear in mind that the business of microinsurance can be an extension of the market; even poor people will agree to pay for insurance if it responds to their perceived priorities.

Microinsurance schemes must learn to apply industry standards for risk management. The main issues revolve around a better link between premiums and the expected cost of benefits, and assimilating the mantra that "good bookkeeping is good business". Commercial insurers must accept an active role in professionalizing microinsurance schemes. Both partners should share the effort to find ways of structuring a legal relationship, rather than hide behind the microinsurer's lack of a corporate structure as an excuse to refrain from forming partnerships. The industry's concerns about high administration costs and a lack of insurance infrastructure are matters that can be largely remedied by the insurance industry itself.

The insurance industry is reluctant to become involved with microinsurers due to the limited prospects of profit. There is no denying that the reward for risk, investment and effort should be profit, and the insurance industry should be entitled to make profits on services rendered. However, the degree of investment and the exposure of the industry to risk have so far been low. In today's economy, profit-taking follows prior investment in creating the infrastructure. There is no reason why the insurance industry would be an exception – why should it look to earn profits but expect others to invest in building the industrial infrastructure that enables such profits to be made? By holding back on its involvement in microinsurance, the insurance and reinsurance industry weakens its claim to draw profits.

What investments should the industry make? This chapter has flagged two key possibilities. Firstly, it can support the development of a capacity-building institution, a “Microinsurance Academy”, to create insurance competence at the community level. Considering the need to have more and better information on the market, and the parallel need to keep the cost of gathering information low, it seems sensible to disseminate domain-knowledge and insurance skills among the people who are active in the microinsurance industry. This is as much in the interest of the commercial insurance industry as it is a matter for public concern.

Secondly, it can enable microinsurance schemes to access reinsurance. Lack of this option is due mainly to the unavailability of supply. As long as reinsurers are reticent to take the lead in offering reinsurance services to microinsurance schemes, it may be opportune to spread this risk over many reinsurers. The practical proposal is to create an institution established jointly by many reinsurers and, possibly, with the participation of public institutions, tasked with offering reinsurance and with developing and implementing a standardized data-transfer protocol that enables microinsurers to buy reinsurance. At present, no natural institutional leader has shown the will to take the lead in creating this facility. However, the initiative of CGAP Working Group and others to accelerate the learning curve of effective microinsurance operations could be extended to include the development of such an institution, because it is an indispensable missing link in enabling microinsurance schemes to make insurance work for the poor.

5.5 The provision of technical assistance

Richard Leftley and Richard Lacasse

The authors appreciate the insights and suggestions provided by Frank Bakx (Rabobank Foundation), Zahid Qureshi (consultant), Karen Schwartz (AAC/MIS), Sabine Trommershäuser (GTZ) and John Wipf (CCA).

Technical assistance (TA) is the provision of expertise on a contractual basis to an organization that needs support. For microinsurance, this could mean assistance with starting a new scheme, launching or improving products, generally upgrading operations, meeting legal requirements or obtaining reinsurance. Provided on either a short- or long-term basis by a variety of individuals and institutions, technical assistance often goes beyond specific technical elements and extends to improving management and governance.

The objective of TA depends on what perspective one has. Donors and policymakers, keen to see a massive expansion of microinsurance, recognize that there is a significant need to build capacity among insurers and delivery channels. Microinsurance providers may seek out technical assistance to expand their product menu, enhance their efficiency or improve their bottom line. As for the TA providers, since this is a new field, they are often interested in developing tools that can be used in different contexts to improve the quality and efficiency of their services.

From the experiences of microinsurance technical assistance providers, this chapter seeks to draw lessons that may help to expand the availability of TA and improve its quality. Although technical assistance is certainly relevant to addressing the meso and macro levels discussed in Chapter 5.1, here the focus is on improving the performance of a microinsurance provider – including both the risk carrier and the distribution channel. The chapter begins by highlighting the importance of technical assistance and then describes the types of TA services commonly offered. The third section categorizes and describes microinsurance TA providers, while the conclusion summarizes modalities and characteristics of quality technical assistance.

1 Why is technical assistance required?

The gap between the supply of and demand for microinsurance is enormous. There are few providers of insurance services to the poor, and even fewer that actually provide a useful service. Yet millions, perhaps billions, of low-income households do not have access to efficient mechanisms for managing risks. To fill this gap, microinsurance technical assistance is required to help create new providers and improve the performance of existing ones.

Technical assistance is particularly relevant for microinsurance because of another gap: a competency gap. Insurance companies naturally have insurance expertise, but they typically have a limited understanding of what the poor need and want. At the other end of the spectrum, persons working for civil society organizations often have a good understanding of the low-income market, but lack insurance skills. Technical assistance can help fill this competency gap by facilitating collaboration between the insurance industry and civil society, and enabling them to complement each other's strengths.

When the two do join forces to enter the low-income market, the TA provider can play a key role. Without the input of an independent third party during the product design process, the insurance company's commercial interests are often promoted above those of the distributor or indeed the clients. An experienced advisor is essential to make sure that the products will be technically and financially sustainable, and provide adequate protection to the poor. In addition, technical assistance can help microinsurers comply with regulations, for example on technical aspects of the products, actuarial projections, capital requirements and solvency.

The field of microinsurance is on a steep learning curve. Most existing microinsurers have developed their expertise through trial and error – indeed many errors. As illustrated throughout this book, where insurance companies have strived to serve the low-income market on their own, most have not provided valuable or valued services; where NGOs, MFIs and other civil society organizations have introduced insurance themselves, they have often encountered product design and compliance problems.

The amount of information and extent of experiences today are dramatically greater than just a couple of years ago. By keeping abreast of the emerging lessons, TA providers reduce the likelihood of the wheel being reinvented and errors repeated. They are key disseminators and propagators of good practice and can transfer lessons from one region to another.

2 What does a TA provider do?

Technical assistance is a broad, all-encompassing term. Indeed, TA can be used to address any need or weakness in an institution, as long as the microinsurer is aware that the weakness exists. In fact, the first step in providing technical assistance is often an assessment – a self-assessment or an external appraisal – that identifies the problems that need to be resolved or the opportunities that could be seized. In general, TA is useful 1) when starting a new organization, 2) when introducing a new product and 3) to support the organizational development of the microinsurer.

Technical assistance can play an important role when setting up a new organization. For example, TA providers might be asked to conduct a feasibility study before any formal decisions are made about launching a new scheme. When starting from scratch, it is always helpful to involve people who have experience in starting or implementing microinsurance elsewhere and who are in a position to set up systems and procedures more quickly.

For organizations that want to develop a new insurance product or improve the quality and acceptance of products already on offer, TA can be extremely useful for introducing and maintaining viable, demand-driven services with a minimum of staff resistance. Generally, technical assistance can be used throughout the product development or improvement processes, or to assist with any of the following interventions along the way:[1]

1. Assess the market

Assistance may be required to assess client needs and demand, quantify the operational realities, assess potential insurance supply including likely rates available from existing insurers, and conduct a regulatory review to see what options are available (e.g. requirement to become a licensed insurance company or agent).

2. Develop product prototype

Based on the market research and institutional assessment, the TA provider can facilitate the development of a prototype product.

3. Price the product

If management accepts the prototype, the product needs to be priced. In the case of a risk carrier working with a delivery channel, the assessment needs to

[1] Note: This is not a product development flow chart, but a list of items in the product development process where technical assistance can play a constructive role (adapted from Leftley, 2005).

determine what rate the insurer will charge, as well as the delivery costs. The combination of the two is what the client is charged.

4. Develop process maps

External advisors can help design the workflow and paper trail to maximize efficiency.

5. Design operations and marketing materials

Before initiating the pilot test, it is useful to have operations manuals, staff training modules, and marketing materials. The marketing focus should be on the development of effective client education materials and techniques.

6. Configure MIS

The management information system (MIS) needs to be adapted to accommodate the new product. For an MFI, to keep insurance separate from savings and credit activities it would be appropriate to install a separate accounting system as well as a suitable tracking system and claims management package.

7. Train staff

Initial training is required for staff who will be involved in pilot testing (and in some cases client training as well). For existing organizations, strategies for overcoming employee resistance to change need to be carefully considered.

8. Evaluate the pilot

Prior to the pilot test, it is important to establish targets that would be considered a success. The TA provider can conduct a review of the pilot test to assess what adjustments are required prior to rollout.

9. Establish a monitoring system

A monitoring system needs to be put in place to track claims, service standards, efficiency and profitability. TA providers can ensure that the system meets management's need for information while monitoring internationally accepted ratios.

10. Link with insurers and reinsurers

If required, the TA provider could assist in negotiations with insurers or reinsurers. Providing a link with reinsurers is especially useful when the insurance market is reluctant to provide cover for the low-income market or for a particular product line (e.g. health or agricultural cover).

Technical assistance is also quite relevant for organizational development, to assist insurers as they evolve over time. Even for successful programmes, external support can be beneficial in preparing a business plan, reviewing management and administrative processes, strengthening governance practices, improving information systems and so on. Actuarial reviews are especially critical to regularly reassess pricing, reserves and product design features *(see Box 104)*. By seeking to professionalize microinsurance providers, technical assistance can help organizations serve their clients better and become more competitive.

Box 104

Actuarial reviews of microinsurance schemes

To determine whether a product is properly priced, insurers usually undergo annual actuarial reviews that compare the claims history (actual claims) to expected claims. This process, known as **experience-rating**, may result in an adjustment to future premium rates depending on the **credibility** attributed to the claims history – the more insured lives, the greater the credibility.

The process of experience-rating not only looks back at the claims history, but also considers how claims trends might be affected in the future. For example at MUSCCO, the savings and credit cooperatives (SACCOs) had paid 2.50 Malawi kwachas per K1,000 of the total savings, shares and loan balances per month for both the life savings and loan protection for many years. When the organization finally brought in an actuary to assess the claims experience, he recommended that rate be increased to K4.25 per K1,000. This significant increase – which was surprising to the board since MUSCCO had been effective in building up reserves – was largely due to the expected effect of HIV/AIDS on future claims experience.

Actuaries also analyse product design features to ensure that they work properly. For example, the Agriculture and Rural Development Center of Catanduanes, Inc. (ARDCI), an MFI in the Philippines with 23,000 clients, had been running an unregistered microinsurance scheme copied from a commercial insurer, complete with a one-year exclusion for pre-existing conditions. However, the MFI's staff members were not trained to properly assess the cause of death. As a result, it was experiencing significant complaints from angry clients whose claims had been rejected. The MFI wanted to retain a similar package, but without the pre-existing-condition exclusion. An actuarial consultant suggested a compromise that included a three-month waiting period and then only 10 per cent of the benefits if death occurred in months four to twelve. This proposal was a huge relief for ARDCI as management realized that it could do away with the exclusion and associated headaches, and still have a mechanism to control adverse selection. [2]

2 The authors would like to thank John Wipf for providing details about ARDCI.

These interventions can be supplied by a TA provider on a one-off basis, through a series of short-term assignments, or during a long-term, on-site consultancy. The appropriate length of the involvement will depend on the type of activity and the budget available, but often better-quality assistance comes from those with a longer-term commitment, either on an intermittent or on-site basis. On-site technical experts might take on the role of manager of the insurance scheme, or manage particular operational aspects, such as underwriting, claims processing or insurance accounting. Another key role of on-site advisors is to train local staff, but this is an expensive approach. The pros and cons of long-term, on-site support are summarized in Table 51.

Table 51 **Advantages and disadvantages of long-term, on-site TA support**

Advantages	*Disadvantages*
1. The consultant will have a better chance of understanding client needs, operational constraints and market potential 2. Often leads to smoother project implementation as consultant is able to provide project management supervision 3. Able to consider more complex products and distribution methodologies 4. Increased input on factors such as relevant MIS for the organization 5. More likely to lead to high level of skills transfer to middle management	1. Local management can become dependent and, in the worst case, fail to "own" the changes introduced by the consultant 2. Often leads to a lower level of understanding among local management as dependence on the consultant grows 3. Significantly more expensive than short-term consultancy 4. The "foreign" consultant can be seen as a threat by local insurance companies 5. Often not required to get a product implemented

3 Who provides microinsurance technical assistance?

To help overcome the tremendous gap between microinsurance supply and demand, and the challenging chasm between risk carriers and potential delivery channels, TA providers have to be experienced persons with technical and business expertise. Since microinsurance is a relatively new field, TA providers usually come from two different backgrounds: 1) microfinance or health experts who have learned about insurance or 2) insurance experts who have learned about the design and delivery of insurance to the poor.

Many different individuals and institutions are involved in delivering microinsurance technical assistance. The main categories include 1) insurance companies or professionals, 2) international technical cooperation agencies, which can be governmental or multilateral and 3) international development organizations, which are non-governmental. The review of TA providers below is not comprehensive or exhaustive. The details of representative providers are listed here to illustrate the types of organizations and persons involved in providing TA, and their diversity of backgrounds and motivations. Drawn primarily from the case studies, the descriptions of TA providers should not be considered to be endorsements of their services.

3.1 Insurance companies, associations and professionals

If microinsurance technical assistance had a vanguard, two organizations would claim to be in it: CUNA Mutual and ICMIF.

In the 1970s and 1980s, **CUNA Mutual,** the United States-based insurance company for credit unions, has also pursued an international development agenda based on cooperative principles. Before anyone used the expression "microinsurance", CUNA Mutual had propagated loan protection and life savings products in credit union associations and mutual insurance companies around the world, including MUSCCO, TUW SKOK (Poland) and ALMAO (Sri Lanka).[3] Besides TA, CUNA Mutual has also made investments in local insurers and provided reinsurance.

By the time microinsurance became known more widely, however, CUNA Mutual had undergone a strategic rethink and largely withdrawn from the realm of microinsurance technical assistance. Yet its legacy remains, with several cooperative-owned insurance companies (and unregulated schemes managed by apex bodies) still operating in many countries. As described in Chapter 4.1, CUNA Mutual's strategy was to keep it simple. Since the insurers' main distribution channel was the credit unions, which lacked insurance expertise, its TA recipients only offered basic products in conjunction with their core services.

What CUNA Mutual did globally for the credit union movement was what, generally speaking, another organization accomplished on a broader scale for the umbrella cooperative movement around the world: the International Cooperative and Mutual Insurance Federation (**ICMIF**), and its regional associations in the Americas, Asia and Europe. Having formally begun technical assistance in 1963, the federation has helped popularly based organizations set up some 25 new cooperative and mutual insurers, besides providing continuing problem-solving guidance to developing insurers within its ranks. Its technical assistance in some cases is coupled with financial

3 The insurance schemes supported by CUNA Mutual were not all "microinsurers". Many credit unions affiliated with CUNA-supported insurers are employer-based and therefore serve as supplementary coverage for persons working in the formal economy. However, many credit unions do include low-income persons, including those in the informal economy, and therefore CUNA Mutual's experiences are quite relevant for microinsurers and TA providers alike.

support from its funding arm, Allnations Inc, to assist emerging insurers in raising capital and meeting regulatory requirements.

The federation's regional association for the Americas has had a notable track record of insurance development work. The Americas Association of Cooperative/Mutual Insurance Societies (**AAC/MIS**) provides technical assistance and grants programmes – funded by USAID as well as the established insurer-members of AAC/MIS – to numerous insurance companies in the region. Many of AAC/MIS' technical assistance recipients over the years, such as La Equidad Seguros in Colombia, have had an interest in reaching out and serving poorer populations. For its 35 popularly based members in Latin America and the Caribbean, AAC/MIS, like ICMIF globally, offers technical assistance, including member-to-member TA, and educational opportunities to new and emerging member societies based on the principles of mutual self-help, democracy in ownership and governance, and equitable sharing of gains and losses.

The TA provided by ICMIF and AAC/MIS is demand-driven, as the association responds to requests from organizations that ask for assistance in forming their own insurance agency, department or company. Both AAC/MIS and ICMIF also assist their members in obtaining reinsurance, often from other network members. For example, ALMAO is reinsured by NTUC Income in Singapore, an arrangement brokered by ICMIF since both are members of the federation.

An emerging player in international development work is the **Rabobank Foundation**, part of the Rabobank Group in the Netherlands. Its focus is to develop awareness of the benefits of cooperative banking and microinsurance. In line with the focus of the foundation, another subsidiary of the group, Interpolis Re, offers expertise to assist local organizations in developing countries in setting up microinsurance schemes – in addition to providing reinsurance. In 2000, for example, Interpolis started supporting Yasiru in Sri Lanka with a package of assistance including funding from the foundation along with TA, information systems and reinsurance.

Interpolis actively participates in the recently created Micro Insurance Association Netherlands (**MIAN**), which mobilizes Dutch insurance experts, including volunteers from Interpolis, to provide microinsurance technical assistance as part of the company's corporate social responsibility.

Insurance expertise is also finding its way into microinsurance through **actuaries and other insurance professionals** from Europe and North America who have decided to apply their skills in developing-country contexts. For example, CGAP funded an actuarial and management consultant to assist VimoSEWA in India from 2002 to 2004. International actuarial consultants have also worked with Spandana and Yeshasvini in India, Grameen

Kalyan (Bangladesh), CARD MBA (Philippines), TYM (Viet Nam), MUSC-CO and others. This development is particularly interesting because it begins to bridge the gap between those with insurance expertise and those who understand the low-income market. By rolling up their shirtsleeves and getting out into the field, these consultants are creating a new class of microinsurance experts.

3.2 International technical cooperation agencies

GTZ implements development projects on behalf of the German Government mainly for the Federal Ministry for Economic Cooperation and Development (BMZ). After a first pilot project on microinsurance with SEWA in 1994, GTZ expanded its microinsurance technical assistance to other NGOs and MFIs. However, usually GTZ provides its services on microinsurance in the context of larger social protection, health insurance or financial system development programmes.

A vast range of capacity-building and advisory services is provided by GTZ. For example, MHOs in West Africa were supported in conducting feasibility studies, product design and insurance administration and monitoring systems. Government officials, healthcare providers, insurers and NGOs were trained to provide quality health microinsurance in Cambodia and the Philippines. In Tanzania, GTZ enabled community-based systems to create a strong national federation, which was officially recognized by the government as a provider of health microinsurance. In Chile and Paraguay, GTZ supports community-based systems to complement social protection efforts by the state.

The **ILO** approaches microinsurance technical assistance from two perspectives: 1) assisting financial sectors in becoming more inclusive and 2) extending social protection to workers in the informal economy. Much of the effort is dedicated to research activities (such as this book and the case studies that it draws upon), as well as developing training materials. In addition, the ILO has also provided technical assistance to microinsurance schemes, particularly those that extend health insurance to the poor.

The ILO's STEP programme helps grassroots organizations set up microinsurance schemes with a package of TA, management tools (including MIS software) and funding.[4] In many of the STEP-supported schemes, the

[4] Besides TA at the provider level, STEP also works at the meso level, providing technical assistance to build the capacity of federative organizations and support organizations promoting microinsurance. At the policy or macro level, the programme organizes advocacy activities, principally aimed at governments, to raise awareness of the usefulness of such insurance schemes and to promote an environment conducive to their development.

managers had no previous experience with insurance. The TA provider guides the feasibility study, and provides the expertise for calculating premiums and setting up the scheme. Technical assistance also includes capacity-building and monitoring, development of annual work plans, assistance in training material development, accounting and reporting and staff training. Some of STEP's TA recipients include AssEF (Benin), VimoSEWA, Grameen Kalyan and BRAC MHIB.

3.3 International development organizations and consulting firms

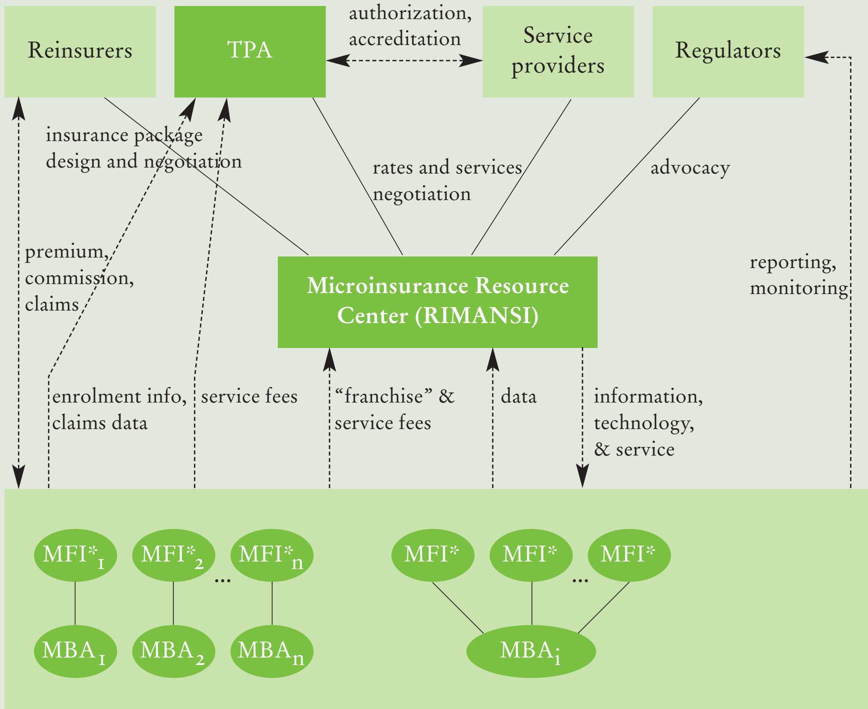
The Canadian Cooperative Association **(CCA)** provides technical assistance through a Philippines-based actuarial technical advisor who has assisted microinsurers including CARD MBA and the Cooperative Life Insurance Mutual Benefit Society (CLIMBS). Besides actuarial services, the advisor assists with the development of IT systems to facilitate the management of microinsurance data. He also works closely with the board, management and staff. With them, he reviews and addresses the insurance risk, and develops management and control systems.

Together, CCA and CARD MBA have created **RIMANSI** (Risk Management Solutions, Inc.), a microinsurance resource centre that provides technical assistance, administration, assistance with regulatory compliance and reinsurance to MFIs and cooperatives in south-east Asia *(see Figure 37)*. In its first year of operation, it supported five MBAs in the Philippines and three microinsurance schemes in Cambodia. Its main approach is to franchise CARD MBA's technology and replicate it.

CIDR is a French NGO involved in various development fields since 1961. It aims at organizing persons in the informal economy to help them assume responsibility for their economic, technical and financial needs. In particular, CIDR works in microfinance, microenterprise development, microinsurance and the management of health services. Through its microinsurance TA, CIDR promoted different approaches in different areas:

- Mutual health organizations (MHOs) organized in regional networks in Benin (20,000 beneficiaries), Guinea (14,000 beneficiaries), Tanzania and Kenya
- Comoros Islands: village-based social security with automatic membership
- Mali: collaboration between a mutual health organization and a microfinance institution
- Uganda: health insurance scheme co-managed with a not-for-profit health-care provider

Figure 37 **The RIMANSI model of technical assistance to MBAs**



Microfinance Opportunities is a client-oriented microfinance resource centre. Established in 2002, its speciality in providing TA is the provision of market research. Microfinance Opportunities has pioneered the analysis of consumer demand for microinsurance and assessing risk management strategies of low-income households. To translate the demand research into product design, Microfinance Opportunities often works with the **MicroInsurance Centre**, a specialist consulting firm focusing on improving access to appropriate insurance products by low-income people. In particular, it assists commercial insurers to develop strategies and products to successfully enter the low-income market.

Opportunity International (OI) is a global network of microfinance institutions operating in 29 countries with a loan portfolio in excess of US$175 million and 840,000 active borrowers at the end of 2005. In 2002, OI became the first microfinance network to recruit an insurance team to help its affiliates develop insurance products. It employs a modified partner-agent model and has developed a range of life, property, disability, unemployment, health, livestock and crop insurance products in nine countries.

Besides serving its own MFI partners, OI has provided some microinsurance technical assistance to external projects including the development of crop insurance products for the World Bank in Africa. In the course of 2005, OI made a strategic decision to establish "The Micro Insurance Agency", a specialist insurance brokerage providing distribution and administration of microinsurance to a range of MFI networks, SACCOs, cooperatives and rural banks.

SOCODEVI is a specialized NGO formed by a network of cooperatives and mutuals in Canada originating from the insurance and financial sector, agriculture and agro-business, forestry and consumers co-ops. SOCODEVI focuses on the promotion and strengthening of the cooperatives as a tool for sustainable development. For twenty years, SOCODEVI has provided technical assistance in microfinance, insurance, agriculture and forestry to partners in Africa, Latin America and Asia.

In insurance, SOCODEVI's approach is to set up cooperative and mutual enterprises that offer high-performing, diversified and accessible products adapted to the members' needs. SOCODEVI helps insurers improve their competitiveness while developing their management and marketing capacities. SOCODEVI's cooperative development programmes involve volunteers from its own membership, so there is a stronger commitment by the TA provider than just completing an assignment. For microinsurance projects, the consultants come from member insurers, commanding a lot of credibility with the organizations where they provide the expertise. Through the years, SOCODEVI has mostly supported insurance organizations in Latin America, including ServiPerú and Columna in Guatemala.

4 Conclusion: Providing quality technical assistance

Despite the diverse nature of these illustrative TA providers, there are some common threads that draw them together. Most organizations fall into the cooperative and mutual camp, which is quite logical since one of the core principles of cooperatives is to support the development of other societies. A second theme comprises organizations that have emerged from microfinance to promote insurance as well. Lastly, the international technical cooperation agencies have a slightly different interest as they tend not to focus just at the institution level, but also strive to deal with relevant meso and macro issues.

On the basis of this list of TA providers and their experiences, and drawing from the literature on technical assistance, it is possible to highlight some preliminary lessons. In general, the process of providing TA requires careful examination to ensure that proper incentives are in place to enhance the quality of the service. The SEEP Network has examined this issue in the context of microfinance, and identified seven key principles (the 7 Cs) that are necessary to ensure excellent TA *(see Box 105)*.

Box 105

The 7 Cs of technical assistance

To derive the maximum benefit from the scarce investments in technical services and to create positive returns on investment in technical assistance, the SEEP Network developed a framework for delivering quality technical assistance. Although its 7C criteria were designed with the provision of TA to microfinance institutions in mind, they have relevance, and are adapted here, for microinsurance providers.

1. Client demand-driven
This principle addresses the need for the TA recipient, the microinsurance provider, to own the TA process and drive the choice of technical services. The principle implies that the microinsurance management team undertakes a self-assessment to define the organization's technical needs and then obtains the technical services required to improve performance.

2. Context
This principle addresses the need to identify the external contextual variables that can influence the choice and effectiveness of technical service delivery, including economic, cultural, political and institutional variables.

3. Concrete results
This principle encourages microinsurers to define and agree to clear results with time limits (and interim steps if appropriate) to be delivered by the TA provider. These deliverables should include concrete outputs for:

- individuals, in terms of their level of knowledge, skills, or attitudes,
- systems (e.g. information or financial), in terms of their performance and/or capabilities and
- the institution, in terms of performance goals related to the technical service.

It is important to note that deliverables should be appropriate for the size, age and capacity of the institutions receiving and providing the technical services.

4. Checkability (indicators to check results)
This principle encourages microinsurers to design and agree on performance measures, or indicators that will verify the delivery of specified outputs by the technical service provider.

5. Focus on Change (baseline indicators)
Inseparable from the idea of Checkability, this principle requires a microinsurer to collect baseline information on its own performance to measure the results of technical assistance. Benchmark indicators may include staff attitudes, knowledge levels, skills, and system and institutional capabilities or performance.

6. Cost-effectiveness
This principle ensures that cost-effective measures will be used to select and verify the delivery of technical services. The principle encourages microinsurers to measure the results of technical services against their total cost (direct and indirect) in order to discern whether such services are worth the expense incurred.

7. Clear accountability
This principle encourages microinsurers to build mutual accountability mechanisms into technical assistance contracts. It emphasizes the need to assign clear roles and responsibilities for each party to achieve specified results, using incentives and/or penalties to ensure that the TA recipient and provider fulfil their commitments to each other.

Source: Adapted from Goodwin-Groen, 2003.

This 7 Cs framework is an effective guideline for improving the quality of technical assistance. Indeed, receivers of technical assistance sometimes complain that the quality and impact of the services did not justify the cost. Often, TA services are supply-driven, with the technical assistance matching the providers' expertise rather than the receivers' needs.

In the process of providing quality TA, some key factors need to be kept in mind:

1. Insurance products must be kept simple and easily understandable.
2. Product benefits should be in line with an affordable premium for the targeted customers.
3. Commitment and strong leadership are required from senior management and the board to accept and implement the needed changes.
4. If the TA recipient requires a long-term intervention, then the TA provider must have a long-term commitment so the two can forge an effective working relationship.
5. Although it may appear efficient, it is not appropriate to promote the same formula or product menu in different countries. While the process of provid-

ing technical assistance may be the same, the results of that process can be quite different depending on the capacity of the TA recipient, its market and the regulatory environment.
6. The TA provider needs a) expertise in the particular technical area and b) the ability to impart that expertise to others, possibly in a context quite different from the one the expert is used to working in. These two qualities can be difficult to find in one individual.
7. TA providers must recognize and respect the absorption capacity of the organization and its staff; a step-by-step or phased approach usually works best.
8. The TA recipients should not only understand what they have to do, but also understand why they have to work differently and be motivated by the new vision.
9. TA providers need to build the capacity of microinsurers to increase the target market's understanding of the benefits of insurance.
10. Effective technical assistance includes continuous monitoring with standards, indicators and benchmarks.

One way to increase the quality of TA, improve accountability and ensure that it is demand-driven is to ensure that the TA recipient actually pays for the technical assistance or at least shares some of the costs. There are a few examples already of multinational insurance companies hiring microinsurance experts to help them develop strategies to serve the low-income market.

However, **funding for technical assistance** often flows from a donor to a consultant or a network organization that then provides technical assistance. The TA recipient may have little say in who provides the services or whether the cost of those services is an effective use of resources. To overcome this problem, some networks such as Opportunity International have required their MFI partners to contribute to the cost of the TA from their own income. In some cases, donor grants have been provided directly to the MFIs, which are then free to choose whether to use an internal TA provider (i.e. within the network) or to access the expertise elsewhere. This type of financing mechanism puts the TA recipient in charge of the process and increases the likelihood that the TA provider will be held accountable.

One strategy for reducing the cost of microinsurance technical assistance is evident in the trend toward **south-to-south services**. Often AAC/MIS serves as a facilitator of technical assistance, linking up the skills of one member with the needs of another. Similarly, the emergence of RIMANSI in the Philippines is an important achievement. Not only is a local TA provider more affordable than international consultants, but it is also more familiar with the context. In West Africa, Développement international Desjardins

(DID) is pursuing a similar approach as it tries to develop the capacity of a local TA provider *(see Box 106)*.

Box 106

Technical assistance partnerships: DID and CIF

The *Centre d'Innovations Financières* (CIF) is a technical assistance provider that works with six networks of savings and credit cooperatives in West Africa (FECECAM in Benin, FCPB in Burkina Faso, Kafo Jiginew and Nyèsigiso in Mali, PAMECAS in Senegal and FUCEC in Togo), which include 500 cooperatives and 1.2 million members. CIF has a particular interest in designing new products to meet customer needs.

Développement International Desjardins specializes in providing technical support and investment for the community finance sector in developing countries. It is a component of the Desjardins Group, the largest financial cooperative in Canada.

CIF and DID are technical and strategic, as well as financial partners. By capitalizing on and combining their international and local expertise, CIF and DID have created a formidable symbiosis. Through CIF's knowledge of local conditions, it can understand the unmet needs of cooperative members. In many places, such as Togo, CIF has identified the need for microinsurance products. It is here that the cooperatives and CIF can benefit from DID's insurance expertise. Besides having its own microinsurance experts, DID has also learned a lot about the insurance business from its parent company.

Together, these partners have developed locally responsive, yet financially viable products to be piloted in Togo. By learning from and building on the experience of the pilot, the products will then be mainstreamed across all member cooperatives. Indeed, the costs and risks associated with developing products in this fashion are much lower because other CIF networks and stakeholders can benefit from the experimentation done in a single network.

In addition, by providing technical assistance to a local TA provider, DID is able to create a multiplier effect. With CIF subsequently leading the development of microinsurance in the other networks, the costs are much lower than if DID had provided technical assistance to each network separately.

Source: Adapted from Tremblay et al., 2006.

Another strategy for improving TA and reducing costs has been for networks to **share resources**. For years, AAC/MIS and SOCODEVI have shared consultants and management of technical assistance to achieve common goals in supporting insurance partners in Central and South America. The organizations agreed on strategies for supporting these partners, including exchange of information to improve the follow-up of TA. One remarkable result of this collaboration was to develop common management tools, set performance standards and jointly seek reinsurance for the TA recipients. The use of common indicators has also allowed for an easier exchange of information and experience between the microinsurers themselves. Many organizations receive technical and financial assistance from multiple donors, encountering problems of consistency of message and recommendations – not to mention duplication of effort. Donor coordination and collaboration, as achieved by AAC/MIS and SOCODEVI, benefit the recipients as well as providers of technical assistance.

A common theme among many of the microinsurance TA providers is the combination of **technical assistance and money**. Grants and investments often accompany the technical assistance for greater impact. Where an investment is made, such as by CUNA Mutual or ICMIF's Allnations, there is a strong probability that the accompanying technical assistance will be of high quality since the TA provider has a vested interest.

Another important link is between **TA and reinsurance**. There have been instances where the local insurance providers have been unable to provide a product or coverage because of their own reinsurance restrictions. If an insurance company has a restriction on its own reinsurance programme, it will limit the coverage it is willing to offer for fear of incurring a net retained loss. A TA provider can provide the connections necessary to negotiate effectively with a reinsurance company to achieve better coverage. For example, when Opportunity International Bank Malawi wanted to offer livestock insurance, it could not find a local insurance company willing to participate as the insurers' reinsurance treaties excluded livestock. OI was able to negotiate with reinsurers in South Africa to allow NICO, a Malawian insurance company, to front the coverage with the risk being carried by the reinsurer in South Africa.

TA providers also have a role to play when the local insurance industry is unwilling to provide coverage because of a lack of technical knowledge. When OI was developing a crop derivative for The World Bank in Malawi, the local insurance companies were initially unwilling to underwrite it as they had no prior experience in pricing similar products. After some discussions with OI's experts, the local insurers formed a pool to underwrite the risk on the basis of OI's actuarial input, product design TA and on-going underwriting support.

A final strategy for maximizing the effectiveness of microinsurance technical assistance is to focus on the **brokering role** of a TA provider. By bringing together an insurer and a civil society organization, the TA provider essentially minimizes the need for technical assistance since the two complement each other in expertise. The TA provider is primarily needed up front as an interpreter, to speak insurance-ese to the grassroots organization and development talk to the insurer. Once the two start understanding each other, the continuing need for the interpreter – the TA provider – is substantially reduced.