

# MICROINSURANCE

## Improving risk management for the poor

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

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CGAP WORKING GROUP ON  
**MICROINSURANCE**

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## Concept

### MICROINSURANCE INNOVATION FACILITY

The Microinsurance Innovation Facility, a partnership between the International Labour Organization (ILO) and the Bill & Melinda Gates Foundation, will be engaged over the next five years in four sets of activities:

1. Offer innovation grants to stimulate new ideas and test new approaches to provide better insurance products to un- and under- served markets;
2. Create a market for technical assistance (TA) by supporting the development of TA providers, while at the same time co-financing the demand;
3. Conduct research to analyze the impact that insurance has on the risk-managing capacity of poor men and women, and identify models of success;
4. Disseminate lessons learned among key stakeholders.

This article explains why the Facility was created, what it hopes to accomplish, and how it will achieve its objectives, with an emphasis on the innovation grants.

#### Background to the Facility

This exciting initiative has emerged out of the work done by the CGAP Working Group on Microinsurance over the past five years. To learn how to extend insurance to low-income persons, the Working Group launched a research project in 2003 funded by DFID, GTZ, ILO and

SIDA to document the experiences of microinsurance operations around the world. This "Good and Bad Practices" project conducted a series of case studies of insurance companies, microfinance institutions (MFIs) and community-based schemes that provide life and health insurance to the poor.

In 2006, on behalf of the Working Group, the ILO and Munich Re Foundation published "Protecting the poor: A microinsurance compendium", which synthesizes the lessons gleaned from the case studies. From an institution level, the analysis of the case studies show that the provision of microinsurance can be viable, particularly when sold through groups, such as community organizations, cooperatives, labour unions and MFIs – delivery channels that already have financial transactions with the low-income market also can help control adverse selection and moral hazard.

Although the evidence at the client level is largely anecdotal, the research indicates that the poor can indeed benefit from insurance as a key tool in their risk management repertoire. While microinsurance does not have the same cachet or public relations value as microcredit, it is a crucial complementary service. The ability of microcredit to help the poor work their way out of poverty is extremely compelling, but what happens to a microentrepreneur when a family member becomes ill or dies?

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All the impact gained from the microcredit support can be lost if a household experiences a peril and does not have a safety net. In many regions, mutual support networks such as aid from friends and family are important, but only provide limited coverage; and even if formal social protection schemes supposedly should be there, they often exclude workers from the informal economy. Consequently, the poor also need to build up a savings buffer that they can draw on for small losses, and insurance coverage for larger losses. Efforts to support the poor's productive needs, like training and enterprise loans, must be balanced by addressing their protective needs through savings, insurance and effective social protection systems.

Another important lesson learned from the research is that there is a need to improve microinsurance significantly by spreading more information. In reality, none of the 40 schemes analyzed could be considered an unqualified success.

Some organizations served a large number of people however, provided limited benefits; others provided excellent benefits but were not yet financially viable; some were poorly managed and had high operational costs, resulting in poor value to low-income consumers; while others seemed promising but had not yet been taken to scale.

Consequently, a new thrust is needed to stimulate further advances, enhance customer value, and dramatically expand outreach through robust, sustainable insurance providers. This conclusion led to the creation of the Microinsurance Innovation Facility, which will support experimentation and expand the realm of possibilities, by sharing greater knowledge and expertise to solve microinsurance challenges.

### Problems the Facility will try to solve

While there are many challenges in extending insurance to the working poor, the Facility is particularly focused on three themes: Improved products, models and consumer education.

#### 1. Products

The poor are more vulnerable to risks than the rest of the population, and yet they are the least able to cope when crises occur. One way for them to protect themselves could be through insurance.

Yet few have coverage and where they do have access to insurance, the products do not usually provide good value, or they do not cover the risks that concern the poor the most. The Facility will encourage more affordable products with greater coverage to serve a wider range of risks with better service.

This notion of "product" is broader than just the price, benefits and terms; it includes the processes involved in managing the product. In that context, challenges include managing huge volumes of small policies, collecting premiums from people without bank accounts, verifying and paying small claims, as well as controlling moral hazard and fraud.

#### 2. Models

There are various institutional options for providing microinsurance, but they all have some limitations. The Facility will support new models and encourage partnerships to leverage the strengths and overcome the shortcomings of present options. It is looking for institutional solutions that are efficient, that provide relevant and affordable coverage to the low-income market, while finding an appropriate balance between the interests of policyholders, delivery channels and risk carriers.

#### 3. Consumer education

Few providers have effectively educated the target market about the benefits of microinsurance. Consequently, the poor often do not understand how insurance works or under what circumstances insurance is a preferred risk management tool vis-à-vis savings or credit. Their acceptance of insurance is further limited by short-term planning horizons, suspicion of insurers' motives and a belief that insurance is only for the rich. In addition, the lack of transparency around pricing and benefits makes it very difficult for consumers to make sound purchasing decisions. Sometimes this lack of understanding left the low-income market vulnerable to exploitation by insurers or their agents. The Facility wants to make insurance more accessible to the poor – not just physically and economically accessible, but also intellectually.

The Facility strives to encourage insurance experts to apply their skills to solving these three microinsurance challenges. It will test the extent to which the working poor can benefit from insurance while still ensuring the viability of the provider. The Facility also wants to support efforts to maximize the efficiency of delivering microinsurance, including the use of new technologies and streamlined processes.

### Innovation grants

The primary objective of the Microinsurance Innovation Facility is: to learn how to provide better insurance coverage to more low-income people, to learn how to develop an insurance culture among the poor, and to understand the extent to which the working poor can benefit from insurance as a risk management tool. To achieve this learning objective, the Facility will support activities that challenge the conventional wisdom. The innovation grants are therefore seen as action research, dynamic efforts to introduce new products, processes or models, or improve on existing ones, or take successful products/models to new markets.

Over the next five years, the Facility will issue 40 to 50 innovation grants for a total of US\$18 million. In the first round of applications, the Facility expects to issue 7 to 12 grants, which are intended to support investments in innovative initiatives and pilot activities, efforts that the applicants believe will be successful but they are not able to undertake without the backing up of a partner. The proposed projects should be designed so that they will be viable at the end of the grant period, either because they are self-sustaining or because additional resources are identified to continue the operations.

The Facility is looking for a diverse portfolio of grantees across the developing world, with a focus on Africa, Asia, Latin America and the Middle East. Although these grants could support insurance for any type of risk, priority will be given to products for which there is a significant demand yet insufficient supply, including health, agriculture, property, and accumulating value life or disability products.

An independent Steering Committee will be reviewing the applications and selecting the grantees. Applicants not selected by the committee may be eligible for a technical assistance grant, which would enable them to purchase the services of a (micro) insurance expert. The technical assistance may assist applicants to refine their approach and strengthen their application for an innovation grant in the future.

For more information, see: [www.ilo.org/socialfinance](http://www.ilo.org/socialfinance) or email: [microinsurance@ilo.org](mailto:microinsurance@ilo.org)

## Concept

### PERFORMANCE INDICATORS IN MICROINSURANCE

Regardless of where the emphasis is placed, all microinsurance programs should aim to become viable since donor or government subsidies are only temporary or not available. Without subsidies, all programs are subject to the same economic and market forces as mainstream businesses and this requires them to be managed professionally. Management goals, however, cannot be achieved without constant monitoring and transparent measurements of performance.

In October 2006 ADA and BRS in collaboration with the CGAP Working Group on Microinsurance organised the first of two workshops in Luxembourg for microinsurance practitioners and experts from around the world with the aim of sharing experiences and to initiate discussions about measuring microinsurance performance. The workshop concluded with the group selecting eight key principles and ten key performance indicators which were then described and briefly discussed in a workshop report. The twenty participating organisations (practitioners from Asia, Africa and Latin America) also provided data from their operations which was used to illustrate the indicators. In July 2007 a second workshop was held to confirm the selected principles and indicators and to test them further with a second round of data provided by the participating practitioners. The workshop concluded with a recommendation of a ninth principle as well as some candidate measures to be considered for social performance indicators.

#### The Nine Key Principles

The key principles and indicators that were established during these workshops are applicable to all microinsurance providers, irrespective of legal structure, environment, delivery model and type of microinsurance product offered. With the involvement of a diverse group of over thirty microinsurers so far, as well as the CGAP Working Group on Microinsurance, we are ensured that a new standard is set for the entire microinsurance industry.

1. Separation of data
2. Collection of relevant and accurate data
3. Production of financial statements
4. Calculation and setting up premium and claim reserves
5. Efficient claims monitoring
6. Clear investment policy
7. Right technical insurance expertise
8. Transparency
9. Client Satisfaction

#### The Ten Key Indicators

The ten key indicators focus on financial viability however, their social performance dimension becomes more apparent when viability is not perceived as the main end, but as one of the requirements towards providing efficient microinsurance products to the poor.

|                                     |   |
|-------------------------------------|---|
| 1. Net Income Ratio                 | $\text{Net Income Ratio} = \text{Net Income} / \text{Earned Premium}$   |
| 2. Incurred Expense Ratio           | $\text{Incurred Expense Ratio} = \text{Incurred Expenses} / \text{Earned Premiums}$   |
| 3. Incurred Claims Ratio            | $\text{Incurred Claims Ratio} = \text{Incurred Claims} / \text{Earned Premiums}$  |
| 4. Renewal Rate Ratio               | $\text{Renewal Rate Ratio} = \text{Number of Renewals} / \text{Number of Potential Renewals}$   |
| 5. Promptness of Claims Settlements | Select only the claims that have been processed and paid from the entire set of claims for a period, and apportion this set of paid claims in terms of the number of days that it took to pay each claim, according to a defined schedule |
| 6. Claims Rejection Ratio           | $\text{Claims Rejection Ratio} = \text{Number of Claims Rejected} / \text{All Claims Reported}$   |
| 7. Growth Ratio                     | $\text{Growth Ratio} = (\text{Number of insured } n - \text{Number of Insured } n-1) / \text{Number of Insured } n-1$   |
| 8. Coverage Ratio                   | $\text{Coverage Ratio} = \text{Number of insured } n / \text{Target population } n$   |
| 9. Solvency Ratio                   | $\text{Solvency Ratio} = \text{Admitted Assets} / \text{Liabilities}$   |
| 10. Liquidity Ratio                 | $\text{Liquidity Ratio} = \text{Available Cash or Cash Equivalents} / \text{Short-term Payables (3 months)}$  |

*“Performance Indicators for Microinsurance – A handbook for Microinsurance practitioners” is now available in English. A French and a Spanish version will be published later this year. You can also request an electronic version of the handbook and if you wish, comments and feedbacks can be sent to [insurance@microfinance.lu](mailto:insurance@microfinance.lu).*

For more information, visit the Performance Indicators sub-group [www.microinsurancefocus.org](http://www.microinsurancefocus.org) ;  
ADA – <http://www.microfinance.lu> and BRS - <http://www.cera.be/brs>

## Case Study Focus

**AL AMANA - REFLECTIONS ON DROUGHT MANAGEMENT LINKED TO RURAL AND AGROPASTORAL LOANS**

Al Amana, one of the leading microfinance institutions in Morocco, has registered an exponential ruralisation of the loan portfolio within the last three years. Drought risk is a common characteristic of the Moroccan climate. Moreover, a rise in the frequency and intensity of drought episodes has been observed for more than two decades. Therefore, the interest was to analyze the relation between the increase in portfolio ruralisation of Al Amana and drought episodes in Morocco in order to highlight the potential repercussions on the global portfolio.

Rural solidarity group lending has been generalized through a network of outposts, essentially since 2005. The dominant activity financed by Al Amana in rural areas is breeding, as the agropastoral loan represented around 70% of the whole rural loans in terms of outstanding amount at the end of August 2007. At the same time, drought episodes became increasingly frequent and intense in Morocco, causing heavy economic, social and environmental damages. Indeed, at the present, there is a drought season nearly every two or three years. As a result, agriculture and breeding sectors suffer more and more from harmful drought effects.

Insofar as breeders constitute the major part of the rural clients of Al Amana, there is a strong risk that drought consequences might affect the repayment capacity of a large number of breeders. According to a rural loan risk analysis from May 2007, agropastoral loans represented 52% of the total capital at risk. Besides, activities linked to livestock represented more or less 40% of the activities financed by Al Amana.

There is a strong necessity that Al Amana becomes conscious of the need to develop one or more drought management tools in order to secure rural repayments. There are two basic types of drought management: self-management and management through partnerships.

The first one can be divided into two categories: the management in the field and the financial management from the headquarters. On one hand, there is the possibility to alleviate drought risk through formation of solidarity group aimed to diversify the type of activity of each group member. On the other hand, field officers can operate as "rural consultants" in order to guide the clients' activities. The financial management refers to either a specific guarantee fund for climatic hazards financed by the clients themselves, or the appeal to derivative climatic products linked to capital markets.

The second one focuses on drought management through partnership with agricultural insurance companies, e.g. the "Mutuelle Agricole Marocaine d'Assurances" and "The Ministry of Agriculture". The first idea consists in the offer of agricultural climatic insurance product, such as rainfall (or vegetation)-index insurance, drought programs for cereals or cattle mortality insurance. The second idea refers to a participation and integration of Al Amana with the governmental programs dedicated to a sustainable management of natural resources linked to agriculture and breeding.

*This short summary is based on an end of year paper of Julien Gerard. The paper can be requested from the author at [bartesque2001@yahoo.fr](mailto:bartesque2001@yahoo.fr)*

## Selected Info

### Glossary

#### Asset-liability matching

A process of projecting future liability streams such as claims, expenses, structuring the corresponding investments, and backing up these liabilities are used to ensure that the required returns and that those maturities are timed and coincide with future cash flow obligations.

#### Capital adequacy testing

Actuarial method of projecting the future business results of an insurer under various adverse scenarios for the purpose of determining the adequacy of capital which will enable it to meet its obligations under any plausible scenario.

Source: Garand, Denis, and John Wipf, 2008: "Performance Indicators for Microinsurance – A handbook for microinsurance practitioners". Luxembourg, ADA, BRS and CGAP Working Group on Microinsurance. Available at <http://www.microinsurancecentre.org/UploadDocuments/Performance%20Indicators%20V.1%20AN.pdf>

### Microinsurance in Focus notes

#### Nr. 6 - Loss prevention and control

Loss prevention also called loss control or loss minimization are viable methods used to evaluate investments premiums over time. It includes the immediate recognition of critical symptoms in order to prevent investments from getting worse as well as giving information when needed.

#### Nr. 7 - Recommendations for commercial insurers

Low-income households could become an on growing profitable new niche for insurers. However, for commercial insurers working with low-income markets is quite unfamiliar and often insurers are reluctant to invest into market research.

[http://www.microfinancegateway.org/resource\\_centers/insurance/focus\\_notes](http://www.microfinancegateway.org/resource_centers/insurance/focus_notes)

### Microinsurance Notes

#### Nr. 8 - Facilitating an Appropriate Regulatory and Supervisory, Environment for Microinsurance

This note addresses the creation of an appropriate regulatory and supervisory system for microinsurance. Insurance is a business of trust and insurers need to act on their promises.

#### Nr. 9 - Visions of the Future Microinsurance and Thoughts on Getting There

This final Microinsurance Note takes a look at the future of microinsurance. The premise of this paper is that massification—providing huge numbers of low-income people with access to microinsurance products that they perceive as valuable—is an important goal for the future.

[http://microfinancegateway.org/resource\\_centers/insurance/insurance1/newsletters#2](http://microfinancegateway.org/resource_centers/insurance/insurance1/newsletters#2)

## News from the Working Group

### **Operation Sub-group**

The Operations sub-group will retire as more specific sub-groups, such as Technology, have now emerged and can serve the advancements in microinsurance more effectively.

The sub-group's objectives were to facilitate the emergence of appropriate insurance products for low-income persons, and to analyze current practices in this field. The main activities were:

- 24 Good and Bad Practices case studies
- Protecting The Poor: A Microfinance Compendium
- 12 Two-Pagers (briefs based on the Good and Bad Practices Research) entitled Microinsurance in Focus Notes
- Microinsurance Innovation Facility
- Preliminary donor guidelines

The members of this sub-group have helped microinsurance to shift from a concept to a concrete reality, in a way that will hopefully improve the volume and value of insurance products to the low-income markets.

### **Agriculture Sub-group**

This sub-group has developed an inventory of all agriculture microinsurance products that can be found on the internet. This list is now available for general comments and for further suggestions. Contact: [jimroth@leapfroginvest.com](mailto:jimroth@leapfroginvest.com)

### **Dissemination Sub-group**

The next Microinsurance Conference will be held from the 5-7 November 2008 in Cartagena, Colombia. A Steering Committee of 18 persons has been formed and a call of proposals is now available on the conference web page: [www.microinsuranceconference2008.org](http://www.microinsuranceconference2008.org)

### **Impact Sub-group**

The Impact sub-group is currently in the process of defining its objectives and activities in order to achieve its main goals. A review of the existing impact research on microinsurance is available. In this regard, the sub-group appreciates anyone who is willing to share any kind of experience or knowledge concerning impact research. Please contact [ralf@mia.org.in](mailto:ralf@mia.org.in).

### **Regulation, Supervision and Policy Sub-group**

The Regulation, Supervision and Policy sub-group shall be shortly completing five country case studies project on the role of regulation in the development of Microinsurance markets. The study maps the experience of five countries: Philippines, India, Uganda, South Africa and Colombia. Findings were presented in March 2008 in Germany at the close workshop organised by GTZ in collaboration with Finmark Trust and the help of local research teams. Members of the various research teams discussed and deliberated on the findings with the Steering Committee. A draft synthesis is to be presented to the IAIS-CGAP Joint Working Group during its next meeting.

### **Capacity Building Sub-group**

The Capacity Building sub-group together with the performance indicator sub-group organised a workshop on the potential of GTZ tools and approaches for capacity building in microinsurance, with the support of GTZ, BRS and ADA. The workshop was a first step

More information on the Working Group activities, microinsurance news and documents on [www.microinsurancefocus.org](http://www.microinsurancefocus.org)

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