

BRIEF 7

Microinsurance for Risk Mitigation and Crisis Recovery

While only 5% of the population was aware of insurance before the 2001 earthquake in Gujarat, India, some 67% were aware of it afterwards.

(AIDMI, 2005)

This brief focuses only on current microinsurance products designed to protect poor microentrepreneurs in the event of massive disasters by covering damage to assets used for income generation—such as livestock and property—and disruption to their livelihoods.

Microinsurance intends to offer the poor protection against specific risks in return for payment of regular premiums proportionate to the likelihood and cost of the risk involved. A growing body of literature on microinsurance highlights design and implementation challenges, but provides some successful pilots in developing countries along with valuable lessons for MFIs that intend to provide microinsurance services to their clients. The available information, however, only provides guidelines to design and implement life, loan and health insurance that protect the poor from personal calamities (for further information refer to other readings suggested at the end of the brief).

Microinsurance, when available at affordable prices, is now recognised as an important financial service providing some protection to the poor in the event of personal and natural disasters. A recent study of microinsurance in Bangladesh shows that health, life and loan insurance are now functioning and covering about one third of the poor. But disaster and livestock insurance are virtually unavailable, and the only institution providing them covers about

4% of MFI clients (Ahmed et al., 2005). While it is important to cover asset and livelihood losses in the wake of a major disaster, many microinsurance experts point to the inability of current microinsurance products to cover such losses from these events (McCord and Cohen, 2005)¹. Information on such microinsurance programs is sketchy due to poor documentation and monitoring, and lack of evaluations to learn lessons. As a result, it remains unclear whether microinsurance is either feasible or effective in the event natural disasters such as highly destructive tsunamis and hurricanes.

¹ Evidence from Tsunami-affected areas of Sri Lanka shows that the majority of the poor lost about 70% of the physical assets used for their livelihoods. Several lost assets such as houses/work space, livestock, boats, and other equipments such as sewing machines. There was also severe disruption to conducting their livelihood activities due to displacement, lack of markets and loss of assets. The poor cope with losses by selling their remaining assets, using savings or borrowing, and accessing grants/public funds. Availability of insurance could have been another useful tool to help the poor in managing disasters.



A. LIVESTOCK INSURANCE

Requiring insurance when financing livestock through bank loans is a practice in several countries, including India. The Grameen Bank in Bangladesh started such a program in the mid-1990s, offering it only to its borrowers via its insurance wing. Grameen's experience, however, showed that the costs of insuring livestock during rainy months have been prohibitively high, due in part to limited staff skills and the inability to pool risks and achieve volume. This has been especially challenging for semi-formal institutions such as cooperatives, credit unions, NBFIs, and MFIs that function in rural areas.

Therefore, MFIs in some countries are now attempting to provide livestock insurance to their clients by partnering with specialised insurance firms that have the ability and skills to design and manage insurance contracts. For example SHEPARD, an MFI operating with SHGs in rural India, offers group-based livestock insurance in partnership with a local insurance agency. The product covers accidental and natural death of cattle financed by a loan. The member pays 4% of the animal's value as a premium, of which 2.25% goes to the insurance partner. The insurance product is voluntary for clients. The number of policyholders rose from 126 in 2000 to 302 in 2002, but fell to 85 in 2003. The product's sustainability has been difficult to assess since the organisation does not measure the costs associated with insurance delivery (Churchill and Ramm, 2004). BASIX, an NBFi in India, has been offering livestock insurance to its borrowers since October

2002. It partners with Royal Sundaram Alliance General Insurance Company Ltd. to offer livestock insurance products. As of March 2004, BASIX had insured livestock for a value of US\$99,534 through this company. However, neither scheme has been exposed to any major disaster. Therefore, one cannot ascertain the robustness of the product as an aid during major disasters.

There are several challenges to managing livestock-insurance projects when the trigger mechanism to settle claims is not very transparent. To increase transparency and reduce the time required to settle claims, index-based schemes for livestock insurance (based on concepts of index-based schemes for crop insurance) are now being considered for pilot projects. Here, weather predictions are used to gauge the severity of damages. The World Bank is now piloting an index-based livestock insurance product in Mongolia in winter blizzard affected areas. The insurance is expected to enhance the financial security of livestock-owning households by reducing the impact of livestock deaths due to the blizzards. It is still early to gather lessons on the viability and effectiveness of the product, which needs to be monitored for results and replication.

B. ASSET/PROPERTY INSURANCE

La Equidad in Colombia developed a comprehensive property insurance product for microenterprises in 1996 to cover for La Nina disaster losses. The insurance was offered through a network of cooperatives and credit unions around Colombia, with 300



policies sold in the first year. However, sales of these policies were suspended the following year, due to a financial crisis in Colombia that led to the collapse of most of the cooperatives La Equidad was using to distribute the product. However, other policies of La Equidad are still in place. Typically, the assets insured by La Equidad ranged in value from US\$200 to US\$6,000 (Churchill and Ramm, 2004). The example shows that the product introduced in response to a natural disaster was not able to withstand another type of major disaster—the financial crises that affected many people in large areas. This raises concerns regarding the effectiveness of the product in the event of another natural disaster.

Recent research in India showed that poor households, on average, lose close to US\$15 every year of their assets due to fires and floods (annual per capita income in India is about US\$420). In the past five years there have been several initiatives to extend microinsurance products to cover asset losses due to natural disasters. For example, the Gujarat State Disaster Management Authority (GSDMA), India, formed after the devastating earthquake of January 2001, has been actively engaged in the rehabilitation or reconstruction of houses damaged or destroyed by the earthquake. Under this agency, beneficiaries receiving grants for reconstruction must purchase a policy from the compulsory housing insurance scheme to protect their investments and prepare for future events. The GSDMA acts as an intermediary between beneficiaries and insurance companies, grouping individual policies and passing on to insurers the compulsory

premium from each individual's final reconstruction grant (AIDMI, 2005).

Caritas India has now designed an insurance product to help the poor that have lost their livelihood equipment and have not received any compensation. Under this scheme self-help groups (SHGs) are formed and four families are made joint owners of livelihood assets—with an agreement. They are registered with the Fisheries Department. Twenty-five per cent of the total cost on the assets is to be repaid in 36 installments through SHGs to the Village Development Council to form revolving funds. Boats and engines are required to be insured along with the lives of the crew, and premiums are paid by the joint owners of the boat through self-help groups. Men in many villages have come forward to get insured under the group insurance scheme of LIC called Janashree Bima Yojana. The pilot scheme needs careful scrutiny, since jointly held assets insured can create multiple layers of misuse of insurance. The requirement for loan repayments to be channeled into a community fund may also create problems since such revolving funds appear to record very low repayment rates and seldom revolve more than once (see FDC Brief # 4 on Loans and Grants in the Wake of Disasters, 2006).

The 'Swayam' micro credit Tsunami recovery program of SEEDS India and Cap Solidarités (France) operating in the Andaman and Nicobar Islands both include compulsory insurance for all assets distributed through the program. While Swayam supports the first year's premiums, further premiums must be paid by the beneficiaries. The



program works with a partner insurance company and provides training for beneficiaries on the importance of insurance for disaster reduction (AIDMI, 2005). The success of a microinsurance program depends heavily on diversification, volume and renewal of clients. The program needs to be studied for renewals when clients are responsible for paying the full premiums.

In another initiative, CARE, India has fostered partnerships between its selected MFI partners and the private insurance company Royal Sundaram, to provide a packaged microinsurance that covers the following: loss of household assets valued up to US\$25, accidental death (including Tsunami-caused death) and health insurance to cover hospitalisation up to US\$125. To receive the package, MFI clients pay all the premiums (about US\$2.50 per year) to the private insurers. The private insurer pays a 15% commission to the MFIs for bringing the clients. The product was rolled out in March of 2006 in the Tsunami-affected areas in the states of Tamil Nadu and Andhra Pradesh and 1200 clients have received it to date (source: Interview of CARE, India by FDC researcher, March 2006).

Micro-insurance products pilot-tested to protect assets of the poor show that providing group microinsurance to MFI clients through established insurance firms can help with claim settlement and also reduce the transaction costs and keep premiums at affordable rates. But MFIs need to be aware that asset insurance is relatively more complex and difficult to provide compared with life insurance.

Verifying claims for asset losses is often a challenge, due to lack of reliable methods to determine the value of the assets and simple and swift mechanisms for evaluation of the loss, especially after the calamity. Several insurers also exclude many disasters, even if they sell the product as a disaster-protection plan for assets. It is imperative for MFIs and their clients to be educated on the coverage and exclusion clauses to avoid disappointment and misunderstanding regarding the usefulness of the product.

It is also to be noted that several programs are mandatory in order for the program to reach scale and reduce costs. For compulsory schemes to be successful, however, policy-level support is needed.

I was in Colombo for a workshop in March 2005 organised by the Sri Lanka Tourism Board and the World Tourism Organisation where microfinance was discussed for reviving micro and small tourism businesses. Representatives from several Regional Chambers of Commerce and SME associations volunteered that even in cases where they had insured their assets, the insurance companies were not settling the claims on the pretext that only in cases where an earthquake was covered specifically in the insurance policy would they consider the case and indicated cover under natural disasters was not sufficient enough. Further some insurers went another step further and said that since the earthquake was not in Sri Lanka and the damage was caused by flooding due to an earthquake elsewhere, even earthquake coverage could not be considered. Since we have moved ahead from the basic justification for the need for insurance, it is important that such bottlenecks are discussed and highlighted to take the industry in the direction needed to help cover natural disasters.

Shivendra Sharma, PlaNet Finance India, Speakers Corner, June 2005, www.microLINKS.org.



C. LIVELIHOOD AND WORK SECURITY INSURANCE

Many poor households lose their livelihoods in the wake of a major disaster. A livelihood protection or work security insurance can help to compensate for income losses due to livelihood disruptions after a major disaster. This can be especially useful in places with frequent and predictable disasters.

SEWA in India has developed a work security insurance to protect incomes of its clients who lose work and assets due to illness, widowhood, accidents, fires, communal riots, floods and other such natural and human-made calamities. The insurance is provided in collaboration with a national insurance company, Life Insurance Corporation of India. By 2005, about 32,000 members were covered. Members pay an annual individual premium of Rs.60 (US\$1.50) for comprehensive coverage of losses worth Rs.50,000 (US\$1100). The microinsurance product is provided through SEWA Insurance, an intermediary between the SEWA clients and the formal insurance companies such as LIC.

One of the major lessons learned at SEWA included the importance of speed in claims processing—essential for avoiding client disillusionment with both the insurance product and the MFI. Also, collaboration with major insurance firms was essential to reduce costs (see SEWA website, <http://www.sewa.org/services/work.asp>). However, the product is not yet tested for a major disaster affecting most of the insured clients.

D. ISLAMIC INSURANCE

In Islamic countries, to comply with Shariah laws, a new form of insurance called *takaful* is emerging—examples include Malaysia and Sudan. It is a slight variation of mutual insurance and is based on mutuality, cooperation, shared responsibility and joint indemnity. Policyholders cooperate among themselves for their common good. Losses are divided and liabilities are spread according to a community pooling system (Patel, 2004).

The first *takaful* company, the Islamic Insurance Company, was established in Sudan in 1979. There are now more than 50 *takaful* companies worldwide and their insurance premiums represent 0.02 percent of world insurance premiums. *Takaful* is used primarily to cover trade-related losses in large businesses.

Studies now show that demand also exists for micro-*takaful* products among the poor. Islamic laws also allow linkages between cooperatives and *takaful* companies (but not cooperatives and commercial insurance companies) to help with increased outreach to the socially excluded poor. However, the outreach of micro-*takaful* is limited by a lack of trained personnel, little awareness regarding this type of insurance among the poor, insurers, and re-insurers, and a lack of appropriate regulations.

Micro-*takaful* schemes are now available for providing health insurance. The Agricultural Mutual Fund, established in Lebanon in 1997, provides health insurance for the rural poor. Premiums are kept down since health costs are low in Lebanon and the program



receives large government subsidies. But the scheme may need to raise premiums if the government withdraws or reduces its subsidies. There is also a need for wider coverage beyond rural areas, for technical assistance, and for reinsurance to help achieve sustainability. As a result, it has been difficult to tailor the product to also provide asset insurance. Also, it has been difficult to provide the product without subsidisation.

E. DESIGNING MICROINSURANCE PRODUCTS FOR NATURAL DISASTERS

Well designed microinsurance products to protect clients in the wake of natural disasters are contextual and require the providers to listen to the clients. It is important for microinsurers to understand the risks their clients face, how they face them now, and what they still need to maintain financial stability and move towards growth. Conducting appropriate research, using a structured product-development process, and partnering with a reputable insurer can best ensure success for microinsurance products (Cohen and McCord, 2005).

Steps in product design

For example, in 2003 Opportunity International (OI) and its affiliate microfinance institutions developed seven microinsurance products covering risks such as illness, death, and property damage. To ensure that these microinsurance products meet the needs of clients, OI conducts ongoing, intensive market research and product refinement.

The client-driven design process proceeds in five stages. First, staff members from OI's Technical Services Division conduct initial visits to the participating MFI to determine controlling conditions such as current business practice and overall vision and values. Second, the products are designed and priced, and internal policy and procedures are formulated. Third, manuals and training materials are created. Fourth, pilot-testing of the product is carried out. Fifth, a nationwide rollout is carried out. Then frequent monitoring and market surveys are required to learn lessons for ongoing refinement and redesign of the product.

The market research and product design stage proceeds in a series of detailed steps to ensure that client preferences are incorporated into new microinsurance products. Market research consists of focus groups to determine the kinds of events that force entrepreneurs to divert working capital from their businesses. For events that are predictable and thus not insurable, information obtained through the focus groups can be used to design suitable credit or deposit products.

For insurable events, parameters such as cost and frequency are clarified, and the information is used to design a qualitative questionnaire focusing on product pricing and delivery details. The output from this questionnaire guides product design. Only after product specifications are developed in-house does the OI partner approach local insurance companies for quotations. This ensures that the product is designed to meet the needs of clients rather than insurers. OI



has found that while the types of product needed (e.g., life, property) are often already available, details such as instalment plans and payment frequency must be tailored to OI's clientele. However, insurers are often willing to negotiate on such points because microinsurance gives them access to individual clients in largely untapped markets. These new markets provide growth opportunities and diversification away from the commercial clients on which insurers in developing countries are often heavily dependent.

The last stage of this client-driven design process is additional market research using both qualitative and quantitative methodologies, in order to refine products as necessary. OI states that some of the best results have come, not in the initial product design stage but rather when products have needed redesigning. This was the case with CETZAM, an OI partner in Zambia. CETZAM staff members were puzzled when their new funeral benefits policy, which initial surveys had predicted would be very popular, failed to meet expectations. Using a client-driven redesign process, they discovered that pre-launch marketing, delivery systems, and certain product features made the policy less attractive to customers in one particular area of the country. These findings allowed staff to modify the product and its marketing, resulting in greatly increased sales.

Premiums

The premiums for the product should reflect the costs of providing the product and indemnities due to losses incurred. Often, however, such actuarially based premiums

are not affordable by the poor. Also, they may not be able to pay in lump sums. This may lead to low renewal of contracts.

A major issue in developing microinsurance products immediately after a disaster involves lack of databases to help with proper actuarial calculations that form the basis for pricing of products. Indeed, SEWA in India took four years to build up a database for calculating premiums. The data were collected by grassroots-level women through the filing of receipts provided to the insured woman and her family members.

Also, many clients find it difficult to pay their premiums in a lump sum. In order to ease premium payments by poor clients, SEWA devised a method to link them to a savings plan. SEWA promotes insurance products through an integrated approach, *sankalit abhigam*, that combines savings, credit and insurance through *Swashrayee* Mandals. Members can save for their insurance premium through small monthly instalments in *Swashrayee* Mandals. At the end of the year when the policy is due for renewal or when new policies are to be purchased, the full premium amount is withdrawn from the account. Members who were not able to contribute the full amount are still insured and the balance of their premium is treated as a loan from the Mandal.

Coverage

The extent of coverage may range from protection against a small portion of the loss incurred as the result of the disaster to near complete coverage of losses. It depends on the scale, diversification and experience, the ability to cross-subsidise between many



insurance products, retention levels and effective partnerships.

Delivery method

Microinsurance schemes can follow various delivery methods. For example, for asset insurance, the most frequent model in India is where the insurance agency provides the insurance product and the insurance delivery institution/organisation (workers union, MFI or NGO) takes up the activity of sales and servicing the clients. Examples include BASIX—India and the recent pilot by CARE—India in Tsunami-affected areas. Alternatively, an organisation such as a MFI can act as an intermediary between the target population and one of the insurance companies. SEWA is an example of such a scheme. The choice depends on the ability and willingness of the MFI to handle both microinsurance sales and regular financial activities.

F. EFFECTIVENESS OF MICROINSURANCE FOR NATURAL DISASTERS

Growing evidence on microinsurance products to protect the poor against natural calamities shows that it can only be effective and efficient if the following items are addressed:

- Large and diversified outreach
- Low transaction costs and premiums
- Renewal rate of insured clients around 75% (lower drop outs; higher retention)
- Good appraisals of assets owned/rented/leased by the poor to help with their livelihoods
- Good data to help fix the premiums

- Good baseline information on livelihood activities and crisis-coping mechanisms of the poor
- Established insurance and reinsurance firms for partnership
- Client awareness and appreciation for insurance products
- Political and donor will to support insurance products rather than quickly intervene after the disaster with grants and cheap loans
- Realisation that some heavy losses affecting many people are non-insurable without heavy subsidisation
- Not all MFIs can/should offer microinsurance products. Demand and supply constraints should be well addressed before launching the service

While it is important to develop insurance products to protect the poor after a major disaster, it has been extremely challenging to design good products at an affordable price and quickly settle claims after the disaster. Also, it has been challenging to create demand for the products in areas that are rarely affected by disasters that cause massive damage. Subsidisation at the product design stage and premiums paid by clients have also become essential in many cases. It has been difficult to design a comprehensive product that can protect the poor from both personal and all types of natural disasters. As a result, a few pilot cases that may demonstrate success may suffer if scaled up and replicated in other places.



At present, a cautious approach is essential in advocating microinsurance as a major tool for natural disaster management of the poor. It can, however, be considered as one of the tools along with other microfinance products such as savings, loans, leasing and remittances to help in disaster management. At best, well tested life and some health insurance products are available to cover loss of life of the income earner and illness during times of disaster.

SUGGESTED READING

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USEFUL WEBSITES FOR INFORMATION ON MICROINSURANCE

- www.microinsurancecentre.org
- www.microfinancegateway.org/section/resourcecenters/microinsurance/
- www.proventionconsortium.org

