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PATHWAYS TOWARDS GREATER
IMPACT:
BETTER MICROINSURANCE MODELS,
PRODUCTS AND PROCESSES FOR MFIs

Craig Churchill, Aparna Dalal, Josh Ling

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CONTENTS

1	> INTRODUCTION	1
2	> THE EVOLUTION OF MICROINSURANCE PRODUCTS	5
2.1	Improving credit-linked cover	6
2.2	Opportunities with savings-linked insurance	10
2.3	Transitioning from mandatory to voluntary insurance	14
2.4	Packaging insurance within a risk management framework	19
2.5	Considering meso-level schemes for disaster protection	23
3	> THE RANGE OF INSTITUTIONAL OPTIONS	25
3.1	Self-insuring	26
3.2	Partnering with an insurer	27
3.3	Working with an intermediary	28
3.4	Creating an insurance company	30
4	> IMPROVING BUSINESS PROCESSES	32
4.1	Product design and pilot testing	33
4.2	Client education and sales	33
4.3	Sales force structure and incentives	37
4.4	Claims processing	38
4.5	Performance monitoring	41
	References	45
	Annex	48

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EXECUTIVE SUMMARY

As providers of financial services to low-income communities, microfinance institutions (MFIs) can be effective channels through which to distribute insurance to poor people. In general, MFIs are beginning to live up to their potential in this regard. According to a survey of 450 MFIs, nearly 70 per cent provide insurance and nearly half of the insurance-providing MFIs offer some type of voluntary cover. These findings suggest that products are evolving beyond the basic credit life insurance that benefits the lenders more than their borrowers.

Having examined the experiences of innovative MFIs, it is clear that they can be effective providers of valuable risk management services that can have a potent impact on clients and MFIs alike. This paper provides a comprehensive review of the challenges facing MFIs that provide insurance to low-income persons and microenterprises, as well as their successes, with a focus on three topics: (1) the evolution of products, (2) the range of institutional options, and (3) improving business processes.

Emerging from this review are ten key recommendations for MFIs involved in microinsurance:

- 1) **Understand market needs and preferences:** The starting point for designing products is the needs and preferences of the target market. Few would argue with that statement, and yet MFIs and insurers repeatedly design products that suit themselves instead of developing insurance that is pertinent for the market. It should be the MFI's role to represent clients' interests, which is in the MFI's interest as well.
- 2) **Prioritize savings:** An MFI's ability to help the poor manage risks can be greatly enhanced if it provides savings services as well as credit and insurance. Insurance linked to savings provides more permanent coverage than credit-linked cover and appeals to a broader potential target group, and is therefore likely to have a greater impact. Savings accounts can also be a cost-effective means of premium collection, and form a valuable part of poor people's risk management strategies. Further, providing savings products can create a strong foundation for selling insurance as both products require the sales force to persuade clients to trust the financial institution.
- 3) **Make mandatory cover valuable:** Insurance that covers all borrowers or all depositors of an MFI is much more affordable than voluntary insurance that is sold to individuals. It is also easier for the MFI to administer, while enabling them to develop back-office expertise and collect data. But the MFI needs to make sure that its clients know about the coverage and appreciate its benefits. Some MFIs have seen an increase in client retention among borrowers when they introduced mandatory cover that clients liked and some have even attracted new borrowers because of it. Credit life can be made more valuable to clients if extended to cover other risks and/or other people, increasing the chances that the working poor can witness the benefits of insurance, which helps with the process of creating an insurance culture.
- 4) **Proactively develop the product menu:** Engaged MFIs are developing insurance products that are aligned with their institutional strategy and core operations. Mandatory cover is a logical starting point. Once an MFI has mastered mandatory insurance, this can be supplemented with voluntary options that enable MFIs to test the demand for insurance and develop sales skills. Expertise with voluntary options could open the door to purely voluntary products offered by MFIs to their existing and prospective customers. Before rolling products out on a large scale, it is critical to pilot test them to validate the product design and streamline operational processes.

- 5) **Improve claims processing:** Claims processing is perhaps the most important aspect of microinsurance operations because it provides the best opportunity to demonstrate value. Insurance hinges on a trust between clients and insurers; if claims are badly managed, clients will not trust insurance. Whether the MFI is the risk carrier or the interface between the customer and the insurer, it is important that it advocates and contributes to a process that administers claims efficiently, prudently and in a way that maximises client value. For most types of insurance, it is often best if the MFI assumes responsibility for paying claims.
- 6) **Apply holistic risk management:** To increase the potential impact of insurance, it is useful to take a holistic view of the clients' risk management needs and design a package of financial and non-financial services that can respond appropriately. A risk management framework includes preventing risks, preparing for them, and coping if they occur. Insurance is just one aspect of this broader approach.
- 7) **Create a demonstration effect:** The objective is to create a culture whereby low-income households naturally see insurance as part of their risk management strategy. To achieve that objective, MFIs need to ensure that the poor can witness that insurance really works. This can include providing simple products that are easy to understand, maintaining clear claims processes, minimizing claims rejections, making use of testimonial marketing material and holding claims ceremonies.
- 8) **Structure for success:** An MFI's loan officers and tellers may not be effective insurance agents unless insurance is closely integrated into their core functions; for purely voluntary insurance, MFIs may need to have specialized personnel who are well trained by insurance experts. MFIs also have a range of institutional options to consider, including various hybrid models, and they may change their model over time. The partner-agent model often works well in the beginning when MFIs are developing an understanding of insurance and building in-house capacity. But MFIs do not always get what they want from the insurer, so some MFIs offer additional benefits themselves. Brokers might be helpful for MFIs that are considering more complex products.
- 9) **Build insurance capacity:** Regardless of whether an MFI self-insures, partners with an insurance company or works with a broker, it should enhance its in-house capacity for a variety of insurance functions, including marketing and sales, claims management and performance monitoring. Although MFIs often prioritize consumer education, they should perhaps give greater attention to staff education. If the frontline staff do not believe that insurance is a valuable risk management tool, it will be difficult for them to persuade clients to purchase the cover.
- 10) **Monitor performance:** MFIs should monitor the performance of their insurance products and assess how they affect both their core operations and their clients. Institutions need to know if the revenue from the product is sufficient to cover costs, and this is only possible if costs are allocated properly across the different activities. And MFIs that use the partner-agent model will be more effective in negotiating better terms for their clients if they keep track of the results, and develop a better understanding of how insurance companies think. Information is indeed power!

These ten recommendations are highlighted throughout the text so it is easy to identify which parts of the document are providing the details for each recommendation.

ABBREVIATIONS AND ACRONYMS

AIC	Alternative Insurance Company (Haiti)
AMUCSS	Asociación Mexicana de Uniones de Crédito del Sector Social AC (Mexico)
CEO	Chief Executive Officer
CRM	Community risk management
FFP	Fondo Financiero Privado
HIV	Human immunodeficiency virus
ILO	International Labour Organization
JOD	Jordanian Dinar
KGFS	Kshetriya Gramin Financial Services (India)
KPI	Key performance indicators
M&E	Monitoring and evaluation
MBA	Mutual benefit association
MENA	Middle East and North Africa
MFI	Microfinance institution
MFW	Microfund for Women (Jordan)
MI	Microinsurance
MiCRO	Microinsurance Catastrophic Risk Organization
MIS	Management information systems
MIX	Microfinance Information eXchange
NBFI	Non-bank financial institution
NGO	Non-governmental organization
NRSP	National Rural Support Programme (Pakistan)
RBAP	Rural Bankers Association of the Philippines
RedSol	Red Solidaria de Microseguros Rurales (Mexico)
RFID	Radio frequency identification device
ROSCA	Rotating savings and credit association
SACCO	Savings and credit cooperative
SEF	Small Enterprise Foundation (South Africa)
SEWA	Self-employed Women's Association (India)
SICL	SANASA Insurance Company, Ltd.
SIM	Social Impact Monitor
TPA	Third-party administrator
TSKI	Taykay Sa Kauswagan Inc. (Philippines)
TUW SKOK	Mutual Insurance Company of Cooperative Savings and Credit Unions (Poland)
USAID	United States Agency for International Development
WRMS	Weather risk management services

INSURANCE TERMINOLOGY

Actuary: A person who calculates insurance and annuity premiums, reserves and dividends.

Adverse selection: The tendency of higher-risk individuals to seek out more insurance coverage on average in anticipation of a greater probability of experiencing the insured event(s).

Agent: An insurance company representative who solicits and negotiates insurance contracts, and provides services to the policyholder for the insurer, usually for a commission.

Bancassurance: Insurance provided through financial institutions as distribution channels, typically linked to banking products provided by the financial institution.

Basis risk: The chance that an insurance payout does not match the loss experienced by the policyholder. This is a particular concern with index insurance, which pays out based on a measurable indicator, such as too much or too little rain, but that indicator may or may not correlate well with the policyholders' actual losses.

Benefits: The amount payable by the insurer to a claimant or beneficiary after the occurrence of the insured event.

Beneficiary: The person or financial instrument (for example, a trust fund), named in the policy as the recipient of insurance money if an insured event occurs.

Claim: A request for payment of a loss that may come under the terms of an insurance contract.

Claim verification: The process whereby the microinsurer verifies and processes claims for payouts.

Co-payment: Mechanism used by insurers to share risk with policyholders and reduce moral hazard, which establishes a formula for dividing the payment of losses between the insurer and the policyholder. For example, a co-payment arrangement might require a policyholder to pay 30 per cent of all losses while the insurer covers the remainder.

Covariant risk: The tendency for either (1) many households to be affected by a risk at the same time, or (2) several risks to consistently occur together.

Credit life: Insurance that covers the outstanding principal and interest of a loan if the borrower dies.

Credit life plus: Enhanced credit life cover that provides additional benefits (in addition to the outstanding principal and interest cover) such as funeral payout, additional risks covered or family members covered.

Coverage: The scope of protection provided under a contract of insurance, and any of several risks covered by a policy.

Deductible: Mechanism used by insurers to share risk with policyholders and reduce moral hazard, which establishes an amount or percentage that a policyholder agrees to pay, per claim or insured event, towards the total amount of an insured loss.

Endowment: Life insurance payable to the policyholder if living, on the maturity date stated in the policy, or to a beneficiary if the insured dies before that date.

Index insurance: A type of insurance whereby the claim payout is caused by triggering a specific index, such as too much or too little rainfall, which is supposed to be well correlated with actual losses of the policyholders.

Lapse: The termination or discontinuance of an insurance policy due to non-payment of a premium.

Moral hazard: Arises when people with insurance use more services than they would if they did not have coverage, because they know they are protected. An example might include failing to take preventative health-care measures or making unnecessary visits to a doctor.

Premium: The sum paid by a policyholder to keep an insurance policy in force.

Rider: An amendment to an insurance policy that modifies the policy by expanding or restricting its benefits or excluding certain conditions from coverage.

Risk pooling: Refers to the spreading of losses incurred by a few over a larger group, so that in the process, each individual group member's losses are limited to the average loss (premium payments) rather than the potentially larger actual loss that might be sustained by an individual. Risk pooling effectively disperses losses incurred by a few over a larger group.

Pre-existing conditions: These are health conditions that are often excluded by insurance policies as a means of controlling adverse selection. To control for this, insurance schemes may require a health check-up before enrolment, or ask prospective policyholders to answer a health questionnaire.

Underwriter: (1) A company that receives the premiums and accepts responsibility for the fulfilment of the policy contract; (2) the company employee who decides whether or not the company should assume a particular risk; or (3) the agent who sells the policy.

Waiting period: The period whereby policyholders cannot access certain benefits for some time after they enrol. A waiting period has essentially the same effect as excluding pre-existing conditions except the insurer does not have to incur the claims verification costs.

1 > INTRODUCTION

Financial institutions that offer savings services and/or credit to low-income households and small businesses remain one of the most popular and effective channels for delivering microinsurance. These microfinance institutions (MFIs), broadly defined, provide insurers with access to a concentration of clients who are clearly interested in financial services.¹ They generally excel at fulfilling the four basic criteria required for effective microinsurance distribution (Smith et al., 2011):

- access to a large client base of low-income persons;
- existing infrastructure at the local or community level;
- existing financial transactions with the target market and effective cash management controls;
- the trust of the target market.

From the MFI's perspective, adding microinsurance to its product mix enables it to achieve both social and commercial objectives. On the commercial side, an MFI's loan portfolio is vulnerable to the same risks as its borrowers. If a client dies or is sick, and is unable to repay a loan or has to withdraw all of her savings, the MFI's performance will suffer. Insurance contributes to an MFI's core business by improving the ability of its clients to manage risk, which improves their ability to repay loans and save more. Insurance can also help MFIs attract new clients and retain more existing clients. For instance, insurance may enable the MFI to maintain a relationship with clients between loans. MFIs can also think about insurance as a way to improve their own profitability, for example as a cross-selling opportunity and a source of commission-based income, and not only as an add-on to their credit or savings operations.

For MFIs with strong social agendas, it is often particularly important to help to reduce the vulnerability of their members through a suite of risk prevention and mitigation interventions that includes insurance. This motivation is reinforced by research highlighting the limited effect of microcredit to reduce poverty and create jobs (Banerjee et al., 2009; Karlan and Zinman, 2009). One reason why microcredit alone does not have a greater impact is because it focuses on productive interventions that increase clients' income, but as soon as microentrepreneurs experience a crisis at work or at home, they can easily be worse off than they were before. Consequently, to increase the social impact of microfinance, MFIs need to couple their focus on increasing clients' income with an equal focus on promoting protection.

Because of the strong potential of insurance to contribute to their commercial and social agendas, many MFIs have begun to distribute it. A review of the MFIs listed on the Microfinance Information eXchange (MIX) Market² shows that of 451 MFIs that reported social performance data (which includes insurance), almost 70 per cent offered insurance, of which 52 per cent offered only compulsory products, 31 per cent offered a combination of compulsory and voluntary products, and 17 per cent offered only voluntary products (see table 1).

A closer look reveals significant geographic differences. South Asian MFIs are the most likely to offer insurance (88 per cent) while 66 per cent of MFIs in Eastern Europe do not offer any. Over 60 per cent of the insurance-providing MFIs in Africa and MENA (Middle East and North Africa) only offer compulsory insurance, perhaps indicating that the insurance market is less developed in these regions. MFIs in East Asia are the most likely to have evolved beyond compulsory cover, with over 60 per cent offering voluntary insurance.

¹ In this paper, "microfinance institution" is not a specific legal term, but rather refers to a range of institutions that provide credit and/or savings to low-income persons, including cooperatives, commercial and rural banks, credit unions, non-governmental organizations (NGOs) and non-bank financial institutions (NBFIs).

² The MIX Market contains performance data from approximately 2,000 MFIs. The data used in this analysis comes from the 451 MFIs that provided social performance indicators for 2010. Given that this is a self-selected subset of the total MIX Market database, it is not possible to generalize from these MFIs to all MFIs, but the subset is similar to the overall database in terms of geographic distribution, as well as the size and age of the MFIs.

Table 1: MFIs offering compulsory and/or voluntary insurance by region (number and percentage)

Region	Compulsory only n (%)	Voluntary only n (%)	Compulsory + Voluntary n (%)	No insurance n (%)	Total
Africa	23 (51.1)	6 (13.3)	7 (15.6)	9 (20.0)	45
East Asia/Pacific	11 (28.2)	6 (15.4)	10 (25.6)	12 (30.8)	39
Eastern Europe/Central Asia	13 (14.9)	8 (9.2)	9 (10.3)	57 (65.5)	87
Latin America/Caribbean	69 (37.9)	19 (10.4)	48 (26.4)	46 (25.3)	182
MENA	8 (40.0)	3 (15.0)	2 (10.0)	7 (35.0)	20
South Asia	37 (47.4)	12 (15.4)	20 (25.6)	9 (11.5)	78
Total	161 (35.7)	54 (12.0)	96 (21.3)	140 (31.0)	451

Source: MIX Market social performance data, 2010

This paper covers territory already well traversed in the literature, including two training manuals on microinsurance that target MFIs (Churchill et al., 2003; McCord, 2011), three chapters in the first *Microinsurance Compendium* (Churchill and Roth, 2006; Enarsson et al., 2006; and Wipf et al., 2006), and two recent papers published by the ILO's Microinsurance Innovation Facility on improving credit life (Wipf et al., 2011) and managing partnerships (Rendek, 2012).

But circumstances are rapidly evolving. While the basics remain valid, the field is seeing a trend towards improved products, a greater variety of business models, and greater participation by MFIs in insurance processes. Drawing on evidence and examples from the literature and interviews with 18 organizations (MFIs, networks and intermediaries, summarized in table 2), this paper describes the experiences of MFIs that have enhanced their microinsurance products and processes to improve client value. The evidence and examples extracted from the literature have been referenced in the paper; the examples not explicitly referenced are based on information gathered from the MFIs.

This paper is written primarily for MFIs that already offer insurance services, in order to provide them with some insights as to how they might improve their offerings, based on the experiences of their peers. Perhaps it will also inspire MFIs that have not been involved in insurance to reconsider their range of products.

The paper begins by describing the typical evolution of a microinsurance product, including five pathways that MFIs might follow to take them from credit life insurance, the usual starting point, to services that provide more benefits for clients. Section 3 outlines the range of institutional models available to MFIs, which is not static either, as MFIs may evolve through different options depending on their capacity, resources and commitment to insurance. Financial institutions are also taking on additional roles as they become involved in the distribution of insurance, as discussed in section 4, with a particular emphasis on sales, claims processing and performance monitoring.

Table 2: Organizations reviewed in the paper

Organization	Country / Region	Type of organization	Products offered (voluntary/mandatory) – no. of active persons covered	Institutional model
ACCION, Latin America	Latin America	Network of MFIs	Multiple products offered by different MFIs	Partner with insurer
Asociación Mexicana de Uniones de Crédito del Sector Social AC (AMUCSS)	Mexico	Network of MFIs and MI intermediary	Life (M and V) – 40,500	Partner with insurer, own intermediary
BASIX	India	MFI	Credit plus includes life, hospital cash, personal accident and disability (M) – 797,462 Livestock (M) – 3,200	Partner with insurer
CARD MBA	Philippines	MFI	1.5 million total for all products: life (M), hospital cash (M), total permanent disability (M and V)	Self-insure
Fonkoze	Haiti	MFI	Credit life and catastrophe (M) – 50,000	Partner with insurer and own insurance company
Kshetriya Gramin Financial Services (KGFS)	India	Rural bank	Personal accident (V) – 86,327 Group term-life (V) – 50,588	Partner with insurer
MicroEnsure	Global	Intermediary	4.4 million total for all products: life (M and V), health (M and V), agriculture (M and V), political violence (M and V), accident (M and V), asset (M and V)	Partner with insurer, own intermediary
Microfund for Women (MFW)	Jordan	MFI	Hospital cash (M for borrowers) – 57,137 and (V for family members) – 450 (pilot)	Partner with insurer
National Rural Support Programme (NRSP)	Pakistan	Multipurpose NGO	Credit life (M) – 600,000 Hospitalization (M) – 3.6 million	Self-insure Partner with insurer
Prisma, Peru	Peru	MFI	Credit life plus (M) – 20,000	Partner with insurer
Prodem FFP, Bolivia	Bolivia	MFI	Life (V) – 49,000 Property (V) – 2,000	Partner with insurer
Rural Bankers Association of the Philippines (RBAP)	Philippines	Network of MFIs	Multiple products offered by network of MFIs	Partner with insurer
SAJIDA Foundation	Bangladesh	Multipurpose NGO	Composite life and health (V) – 100,000	Self-insure
SANASA	Sri Lanka	Network of financial cooperatives	Multiple products offered by network of cooperatives	Own insurance company
Select Africa	Swaziland	MFI	Credit life (M) and funeral (V)	Own

	and other countries		– 35,000	insurance company
UNACOOPEC	Côte d'Ivoire	Network of MFIs	Funeral (V) – 66,000	Partner with insurer
VimoSEWA	India	MI intermediary	100,000 total all products: composite health, asset and personal accident (V), health (V), life (V), savings-linked (V), hospital cash (V)	Partner with insurer, own intermediary
VisionFund	Indonesia	MFI	Savings-linked insurance (V) – 360	Partner with insurer

Note: The terms used in this table are explained and discussed in sections 2 and 3.

2 > THE EVOLUTION OF MICROINSURANCE PRODUCTS

By protecting policyholders from major risks, insurance benefits both the financial institution and its clients. To protect itself, a financial institution needs to assess its major sources of risk. The death of a borrower is an obvious example of an event that causes problems with loan repayments. As a result credit life insurance is the starting point for most financial institutions. While it remains the most popular product among MFIs, it is often the only product they offer.

Despite the difficulty in developing the range of products beyond credit life, it is indeed possible, and even desirable, as clients are not just vulnerable to death risks. For example, as illustrated in table 3, in East Asia and the Pacific and Eastern Europe and Central Asia, agricultural insurance is sold by one-third of all MFIs that offer insurance. Similarly, almost 40 per cent of insurance-offering MFIs in East Asia and the Pacific provide health insurance.

Table 3: Percentage of MFIs that offer insurance, by product and region

Region	Type of insurance						
	Credit life	Life	Agricultural	Health	House	Workplace	Other
Africa	66	9	3	11	0	3	37
East Asia/Pacific	73	38	35	38	12	4	50
Eastern Europe/ Central Asia	62	17	31	10	24	3	38
Latin America/ Caribbean	84	34	4	11	7	4	27
Middle East/North Africa	73	9	0	18	0	0	27
South Asia	89	27	10	11	0	1	20
Overall	80	27	10	14	6	3	28

Source: MIX Market Social Performance data, 2010.

A closer look at the MIX data also shows that older and larger MFIs are more likely to offer voluntary insurance. Almost 34 per cent of mature MFIs (in operation for more than eight years) offer voluntary insurance (with or without compulsory insurance), compared to 27 per cent of MFIs operating for four years or less. Similarly, MFIs with more than 20,000 clients are also more likely to offer voluntary insurance (42 per cent) than small and medium MFIs (25 and 29 per cent respectively). These findings illustrate that as MFIs grow and mature, they can gather better client information, gain experience, build in-house insurance capacity, and develop a broader range of products.

Product evolution can take a variety of forms, such as providing protection for previously uncovered risks or introducing tangible services, such as medical check-ups with hospitalization insurance, so that policyholders benefit even if the insured event does not occur. The reasons for following a particular pathway depend on a number of factors, largely influenced by the MFI's strategic objectives and business plans.

To assess its risks, a financial institution can start by examining the major causes of delinquency. Indeed, considerable data for developing and expanding insurance already exist within most MFIs' management information systems (MIS). Institutions that have undertaken that exercise often find that late payments and loan losses are frequently caused by insurable risks. For example, when KGFS, a rural financial institution in India, analysed why women borrowers were

late with repayments, it realized that it needed to expand its credit life cover to include spouses. Women were not able to repay loans when their husbands died, not only because they had lost an important source of income, but also because they were not allowed to work for cultural reasons. Similarly, the need for Fonkoze's catastrophe product was identified after an analysis of the effects of natural disasters on clients showed that these affected their ability to repay loans. Fonkoze, a MFI in Haiti, was being forced to approach donors to recapitalize its loan portfolio after a hurricane or earthquake. To protect its clients' well-being and its own portfolio, the MFI needed to insure against the effects of disasters that are increasingly striking the Caribbean.

It is quite common for MFIs to start with a credit life product and then over time add additional benefits, including covering family members and others. Some may offer voluntary riders to give borrowers a choice even if the core insurance offering is mandatory. In fact, as summarized in figure 1, this paper describes five evolution pathways seen among MFIs, which are not mutually exclusive – each financial institution may follow several of these pathways.

Figure 1: Five pathways of microinsurance product evolution



2.1 IMPROVING CREDIT-LINKED COVER

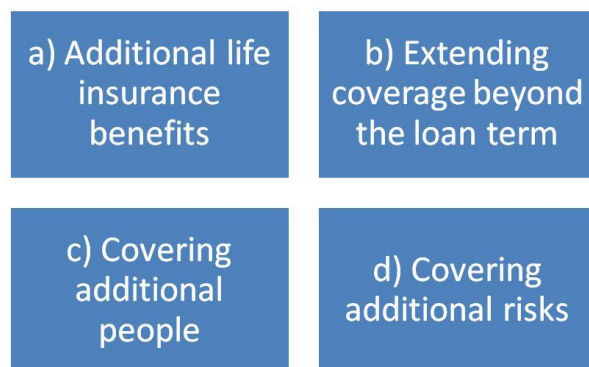
For MFIs that provide credit life insurance, the first step is to improve the value of the product to clients. As insurance that covers the outstanding loan balance on the death or permanent disability of a borrower, credit life is a logical starting point for MFIs new to microinsurance. It is generally easy to introduce, simple for borrowers to understand, and perceived favourably by financial intermediaries as it reinforces their core business.

MFIs that provide credit life fall into two broad categories. The first group offers insurance primarily because it benefits the financial institution by reducing its risk exposure, while possibly generating an additional source of income. The MFIs in this category are likely to have low claim rates and their clients may not even be aware of the coverage. Where regulations restrict the interest rates that MFIs can charge, they may be using the insurance premium as supplementary revenue to circumvent usury laws. The practices of these MFIs represent a threat to consumer protection that could undermine the development of microinsurance.³

³ To raise awareness about the consumer protection challenges that can emerge from microinsurance, the Smart Campaign and the Microinsurance Network developed *Smart Microinsurance*, a guide to help MFIs incorporate client protection practices into their operations. The guide gives client protection guidelines for product design and partnering with insurers, and for different phases of insurance distribution. See http://centerforfinancialinclusionblog.files.wordpress.com/2012/06/smart_insurance.pdf.

MFI in the second category recognize that insurance can benefit both the institution and its clients. This group supports the evolution of their credit life product so that it can be a building block to more comprehensive cover. The first step in this evolution is to introduce enhanced credit life, or “credit life plus”, which goes beyond the outstanding loan balance. As illustrated in figure 2, credit life plus might include four variations.

Figure 2: Credit life plus: four ways of enhancing credit life insurance



a) Providing additional life insurance benefits: Besides covering the outstanding balance of the loan, this way of enhancing credit life also provides benefits such as payment for funeral expenses. Select Africa, an MFI operating in Swaziland and other African countries, provided a free funeral benefit worth 3,000 Rand (US\$ 400) as an incentive for beneficiaries to get the death certificate required for the insurer to pay off the outstanding balance of the loan. In the Philippines, besides covering the disbursed loan amount in the event of a borrower’s death, CARD MBA pays a life insurance benefit that is adjusted based on the length of membership. For example, if the member has been with CARD for more than 3 years, then the benefit is US\$ 1,200 for a natural death and US\$ 2,400 for an accidental death (Matul et al., 2012).

One can make a strong argument that this type of insurance should be the starting point, not the basic credit life that only covers the loan balance. By providing a tangible benefit to the next of kin, such as a funeral payout, the MFI can contribute to the creation of an insurance culture as low-income households see the results of insurance and begin to appreciate its benefits. Plus, by paying claims to beneficiaries, the MFI helps its clients to develop familiarity with insurance, and can build on this foundation with other types of cover. This would not happen if they just wrote off the outstanding debt.

MFI that offer this additional benefit should consider separating the two components for more accurate pricing, with one premium for the declining loan balance and a separate premium for the fixed benefit of the cash payout. For instance, Banco Compartamos in Mexico covers the risk of outstanding loan losses due to death through a self-administered reserve fund. In addition, it provides clients with a US\$ 1,200 term life policy that is covered by an insurer (Wipf et al., 2011).

Alternatively, instead of having credit life at all, the MFI can ask borrowers to take a mandatory term life insurance policy when they take out a loan, and then the beneficiaries are responsible for repaying the borrower’s outstanding loan in the event of death. For example, Taykay Sa Kauswagan Inc. (TSKI) in the Philippines provides a mandatory life insurance for its borrowers instead of credit life. With advice from MicroEnsure, a microinsurance intermediary, it implemented several changes to its insurance arrangement to improve the value of the product to clients. The sum assured was increased to ensure that the benefit fully covered the loan and funeral costs and provided a payout to the beneficiary (Matul et al., 2012).

The disadvantage of offering credit-linked life insurance rather than credit life is the extra transaction that must occur when a claim is made. Instead of the MFI being paid directly by the

insurer, it must collect the outstanding loan from the next of kin. This additional transaction is eclipsed by the advantages. It is a more transparent approach. Borrowers are more likely to know that they have bought insurance and how much they paid for it. During the public claims process, the whole community can see that the insurer is fulfilling its contractual obligations. The awareness of having insurance and the experience with the claims process can lay the foundation of an insurance culture.

b) Extending cover beyond the loan term: A major limitation of credit life insurance is that low-income households are only covered when they have outstanding loans. Since most people would prefer not to be perpetually in debt, MFIs need to develop mechanisms to continue the insurance coverage in between loans, or when clients have stopped borrowing. For example, CARD MBA provides such an arrangement, so that former clients can remain members of the MBA (mutual benefit association) even after they have stopped borrowing from CARD, as long as they continue to pay their premiums (McCord and Buczkowski, 2004).

c) Covering additional people: Many MFIs have expanded credit life to include other people, especially spouses. Where MFIs serve primarily women, clients tend to be more concerned about coverage for spouses than coverage for the loan (Banthia et al., 2012). Some organizations also include children and even parents of the borrower. For example, TSKI requires clients to enrol family members in its credit-linked life insurance product. A family premium rate was introduced and the definition of dependants was made more inclusive to adapt to family situations in the Philippines. Clients who do not have children can add up to two siblings or parents as dependants (Matul et al., 2012).

Besides responding to the preferences of low-income women, the inclusion of additional people on the policy enables the MFI to substantially increase the number of persons covered without a corresponding increase in the work required. For insurance to succeed, large numbers are generally preferable. Not only does this result in economies of scale and more accurate estimations of risk, but also when more people are covered, it increases the likelihood that there will be demonstration effect opportunities.

However, the inclusion of additional lives adds complications that have implications for an MFI's operations. To begin with, it requires additional documentation to know who is covered, such as copies of identity papers. It is also important to recognize that the risk profile of the additional persons will be different from that of the borrower. In Uganda a credit-linked product underwritten by the insurance company AIG and distributed by several MFIs experienced a mortality ratio of one female client death to four spouse deaths (McCord et al., 2005); and CARD MBA experienced one client death to 3.2 spouse deaths (McCord and Buczkowski, 2004). To manage the added risk, MFIs and insurers can begin the product with a moderate benefit for the spouse that increases as the true risk is better understood. In contrast, if children are covered, they are likely to be a much lower risk than their parents, except for the very young. Consequently, some schemes only cover children who are more than five years old.

d) Covering additional risks: A logical next step is to cover risks besides death that affect the stability of the borrower and consequently the MFI as well, but still on a mandatory basis. Besides a rider that protects against total and permanent disability, which is commonly a part of a basic credit life cover, some schemes cover business assets, livestock, health and even natural disasters.

For example, some MFIs protect **assets**, such as business premises and inventory, against fire. Opportunity Bank in Uganda provides short-term loans to a large number of market vendors to purchase inventory. The bank's credit life insurance protects not only against the death of the borrower but also against fire – if a fire destroys a vendor's shop the insurer will pay off the outstanding loan. Opportunity Bank is exploring the possibility of extending fire cover to protect the borrower's business assets, not just the outstanding loan. Such cover could be easily added to the existing credit life product to protect the entrepreneur's equity, which has been built up over months or years (Wipf et al., 2011).

A few MFIs have also added a **health**-related cover to their credit-linked insurance. For example, in Jordan, Microfund for Women (MFW) introduced a hospital cash product for its borrowers, who are primarily women, which pays out if clients are hospitalized. Clients are automatically covered when they take a new loan from MFW. The product costs 12 Jordanian Dinars (JOD) per year (US\$ 16.5), with the premium collected in monthly instalments along with loan repayments. Clients can claim benefits of JOD 15 (US\$ 21.2) for each night spent in the hospital, up to a maximum of 30 nights per claim. In Zambia, Madison Insurance offers credit life plus, through banks and MFIs, that includes a benefit for serious illnesses that will pay loan instalments for the sick borrower for a maximum of eight weeks or three monthly instalments, depending on the repayment schedule (Manje, 2005). After doing research to better understand the risks that its members were particularly concerned about, CARD MBA introduced an additional benefit that covered hospitalization costs incurred because of motor vehicle accidents (Matul et al., 2012). BASIX in India added a hospitalization benefit to its credit life plus product in 2004 as its first non-life cover. The benefit included a payout of 300 rupees (INR) (US\$ 5.55) per day for up to five days in hospital for the borrower or their spouse. The daily benefit was subsequently increased to INR 500 (US\$ 9.25) per day after BASIX reviewed the performance of the product with the insurer.

Most mandatory credit-linked health benefits do not cover health expenses directly. Instead, they provide a fixed payout in the event of a specified health event or pay loan instalments, arrangements that are intended to assist borrowers to cope with the supplementary costs of health problems, but not the actual health costs. It is a useful entry point to health insurance for MFIs because it is easier to design, does not involve relationships with health-care providers, and claims processing does not require specialized health expertise. In addition, because the benefit is smaller, the premium is lower, so there is less resistance to making it mandatory for all borrowers. It is challenging to provide more comprehensive benefits with mandatory insurance, as the Pakistani MFI Kashf Foundation learned. It experienced significant drop-out when it required borrowers to pay for health insurance. That does not mean it is impossible to cover actual health-care costs through a mandatory product – Jamii Bora in Kenya and NRSP in Pakistan both cover hospitalization costs for all borrowers – but they tend to be the exception rather than the rule.

When MFIs offer **agriculture or livestock insurance**, it is usually linked to a loan. For example, BASIX offers livestock and weather-index products linked to livestock and agricultural loans respectively. Similarly, Indian cooperative banks require farmers to buy insurance when they take a loan to purchase an animal. The insurance term typically coincides with the duration of the loan, and premium rates are 3 to 5 per cent of the disbursed loan amount. A major challenge in livestock insurance is preventing fraud by ensuring that the dead animal was actually insured. Cattle are identified with plastic ear tags, or more recently with radio frequency identification devices (RFIDs) inserted below their hide. This technology and the related change in processes, piloted by cooperative banks and the Indian insurance company IFFCO-Tokio, has helped to minimize fraud and enhance the viability of these schemes (Dalal et al., 2012).

To ensure that all borrowers are protected, credit-linked cover is mandatory, which also enables the insurer and MFI to reach scale, and consequently viability, faster. Can mandatory products provide client value? The example of IFFCO-Tokio and the cooperative banks illustrates how client value of a credit-linked product can be improved by changing business processes (see box 1).

Box 1: Improving the value of credit-linked livestock insurance

In 2009 the Indian insurance company IFFCO-Tokio introduced a credit-linked livestock insurance product for farmers, distributed by cooperative banks or cooperative credit societies, that protected against the death of cattle by disease or accident. During the pilot, the insurer made several changes to the product and business processes, which improved the value of the mandatory product for borrowers.

These included:

- Door-to-door service for clients: IFFCO-Tokio used its own staff to enrol farmers in their communities, reducing the travel time for borrowers.
- Faster claims processing: The modified claims process resulted in most claims being paid in 8 to 30 days, which was a major improvement when considering that industry-wide, claims filed for cattle identified by ear tags could take up to 6 months to process. This improvement happened largely because IFFCO-Tokio required its staff to visit the farmer within 6 hours of notification.
- Reduction in transaction costs: Farmers no longer needed to pay for veterinary services, because these were provided by IFFCO-Tokio. This was a major benefit because the cost of the health certificate or post-mortem could equal 50 to 60 per cent of the annual premium. IFFCO-Tokio negotiated lower fees with the veterinary surgeons because of a promise to provide larger volumes.
- Value-added services: Knowledge about mortality rates of breeds, for example, was passed to farmers. In certain districts, IFFCO-Tokio provided deworming tablets. Providing value-added services makes business sense for the insurer if it leads to healthier cattle and fewer claims.

Source: Dalal et al., 2012

It may even be possible to cover **disaster**-related risks with loan-linked insurance. In Haiti, Fonkoze offers such a catastrophe insurance cover, described in more detail in box 8. Client feedback obtained systematically through its social impact measurement unit indicates that the cover has made the loan more attractive to clients, who value the benefits given the high frequency of natural disasters in Haiti.

Another option is to consider a **composite product** that covers multiple risks. For example, the SAJIDA Foundation in Bangladesh offers a mandatory insurance package that consists of health, life and fire cover, as well as educational scholarships and legal services. Clients pay the annual premium of 250 takas (US\$ 3). The offering is an interesting combination of insurance and value-added services that aim to reduce client's vulnerability to risks. In general, however, composite products can substantially increase the costs to the borrowers, and since this involves a mandatory product, it is absolutely critical that clients are concerned about the risks covered. Otherwise, in competitive micro-lending markets, clients may choose to borrow from other MFIs rather than to pay for cover that they do not want.

In sum, an important advantage of covering additional risks is that it provides better protection and increases the likelihood that borrowers will have a chance to see the benefits of insurance. A disadvantage is that additional benefits associated with mandatory insurance increase the costs to borrowers, which can result in lower client retention if they do not appreciate the insurance. However, if the cover does correspond with borrowers' priorities, the MFI can position the cover as a competitive advantage, at least until competing MFIs copy the scheme.

2.2 OPPORTUNITIES WITH SAVINGS-LINKED INSURANCE

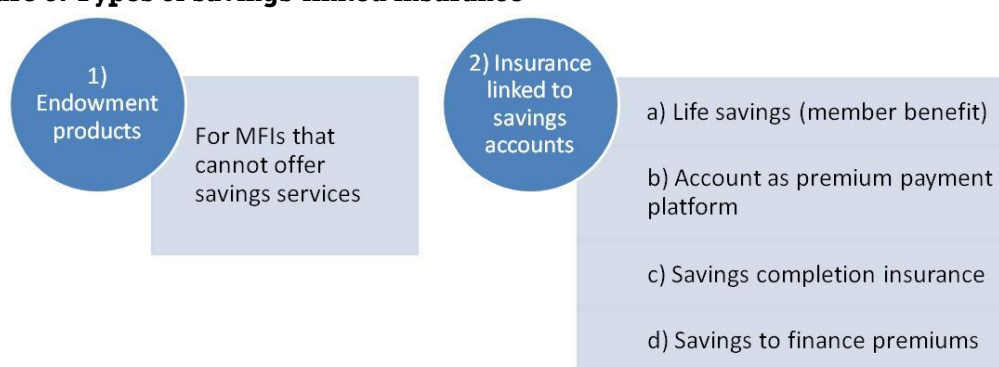
The second microinsurance pathway for MFIs is to offer savings-linked products. As with savings accounts, this type of insurance involves customers entrusting their money to the financial institution in return for a future obligation, in this case, paying money in the event of a claim. Unlike a loan where the lender is taking the risk, insurance and savings products require that the customer trust the MFI.

Savings-linked insurance holds two advantages over credit-linked products. First, most people need savings mechanisms and hence savings-linked insurance can appeal to a wider pool of clients, not just the subset of people who borrow money. Second, savings products typically have

a longer duration, providing a platform for MFIs to offer more permanent protection and build customer loyalty.

Savings-linked insurance products can take two primary forms, as illustrated in figure 3. The first type is an endowment product that accumulates value, where the insurer keeps and invests the savings for policyholders. Such products are attractive to MFIs that cannot offer savings themselves due to regulations. By collaborating with a life insurance company, the MFI can offer a saving and insurance service to their clients. These products can be attractive to clients because they have something to show for their premium payments if the risk does not occur. However, endowment products have historically not provided particularly good client value because a significant portion of premiums go into high administrative costs and commissions, and policyholders can lose what little value they have accumulated if they do not regularly pay their premium (Rusconi, 2012).

Figure 3. Types of savings-linked insurance



As described by Rusconi, some innovations are occurring with these products to make them more relevant for the low-income market, particularly in India, where most MFIs are not able to offer savings services. For example, SKS implemented such a product successfully in partnership with Bajaj Allianz and was able to cover more than 3 million policyholders. The product allows policyholders to pay premiums through the MFI at different intervals, between monthly and annually, with a guaranteed maturity benefit, low surrender penalties (if they want their money before the end of the term), and an insurance benefit that pays a fixed amount for natural and accidental death. As explained in box 2, an endowment product can also provide leverage to MFIs against defaults, such as those experienced by MFIs in India in the wake of the microfinance crisis.

Box 2: Benefits of savings-linked insurance for the MFI

The 2010 microfinance crisis in India made the MFIs realize the value of savings-linked insurance. Most MFIs in India are not allowed to collect deposits because of regulation. Due to the easy availability of capital before the crisis, most of them were concentrating exclusively on credit. When defaults started mounting, even from members who had previously repaid seven or eight loans, MFIs realized how vulnerable they were in absence of any leverage. Savings-linked insurance can, in such circumstances, act as a hedge against such deliberate defaults, even if the MFI does not have an official lien on the savings-linked insurance policy of the borrower.

Source: MFI interviews

For MFIs that do offer savings, offering endowment products is less interesting because they would rather manage and invest clients' deposits themselves. These organizations are more interested in the second type of savings-linked products shown in figure 3, which can reinforce the MFI's core saving service. This arrangement can be structured in at least four different ways.

a) Life savings: One option is for institutions to offer life insurance as an added benefit to a savings product. This is a common approach among credit unions that offer "free" life savings cover, which pays an insurance benefit that is a multiple of the average account balance when the insured member dies. The product is intended to give depositors an incentive to increase their savings, as the coverage increases with the savings balance. As with credit life, because it is a member benefit, it can provide an initial step towards creating an insurance culture within the customer base as long as they have a positive impression. When MicroEnsure and StarLife Assurance offered such a product through a bank, they saw surprising increases in member deposits, as illustrated in box 3.

Box 3: Add-on insurance increases deposits

In 2011 MicroEnsure launched a savings-linked product with a bank in Ghana that had been experiencing low account balances and limited transactions. Although the bank had over 100,000 depositors, more than 85 per cent held a balance under US\$ 60. These customers each actually cost the bank about US\$ 0.24 per month in administrative costs. The bank wanted to provide an incentive to customers to increase their savings balance. Interest rates had proven to be ineffective, as a few cedis each month were not enough to encourage people to save.

MicroEnsure and its partner StarLife Assurance launched an insurance product that was tied to the savings accounts. Depositors who held a minimum balance of US\$ 60 each month were entitled to free life insurance with benefits of up to US\$ 180. Clients with a balance of US\$ 120 were entitled to life insurance for their spouse and children as well. The bank paid the premium to StarLife Assurance instead of a portion of the interest that clients would have received, although no interest was deducted for clients with higher deposits. StarLife marketed the product via SMS, in-store marketing, posters and telemarketing at a cost of less than US\$ 0.50 per client.

The results were surprising. In the first five months after product launch, the bank's deposits increased by 19 per cent. Deposits from clients with balances below US\$ 60 increased by 207 per cent in five months as clients saved more to access the free insurance. This increase along with anecdotal evidence from interviews with depositors suggests that many customers changed their savings behaviour as a result of the additional insurance cover.

Source: Gross, 2012.

Such a product will only be successful if it is valued by the MFI and its clients, which has not been the case for SANASA Insurance Company Ltd. in Sri Lanka. Its life savings product has not had a material impact on savings volumes, which is partly because few of its savings and credit societies have purchased this insurance. They are reluctant because the societies have to pay for the product themselves, at the rate of 0.55 per thousand per month on the total value of deposits. Financial institutions often prefer products that allow them to charge their members additional fees and generate additional revenue for the MFI, to member-benefit cover that the MFI has to buy, unless those benefits are coveted by the members and therefore serve as a competitive advantage for the MFI.

b) Savings accounts as premium payment platforms: This is a standard bancassurance approach whereby the savings account holders are targeted for a sales pitch for voluntary insurance, and premiums are automatically deducted from their accounts on a regular basis.

For example, at BancoSol in Bolivia, account holders have three options: life insurance, life and health insurance, or life and health insurance with additional accidental cover. BancoSol's insurer, Zurich, has set up a system to automatically debit the monthly premium from the account if there is sufficient balance, and if not, to send a shortfall message to the bank and retry each day to see if the account has been topped up. If such a product were attractive to the general public, it could be used to recruit new depositors since having a savings account is a pre-condition for accessing cover, although controls such as waiting periods would need to be in place to protect against adverse selection (Churchill and Grandchant, 2008).

c) Savings completion insurance: This insurance is tied to a contractual savings product, and provides protection if clients are not able to complete their savings goals because of death or disability. This type of cover may be interesting for MFIs as it helps to make contractual savings more attractive.

TUW SKOK, the primary provider of insurance to Polish credit unions, offers this cover to encourage credit union members to develop a regular savings programme. The member determines the savings goal and time period, up to a maximum of 10 years. The credit union then calculates the amount of the monthly deposit needed to achieve the savings target and the monthly premium. In the event of the accidental death of the member, TUW SKOK pays the beneficiary the difference between the savings target and the savings balance at the time of death. There is also a disability component that supplements the member's salary if he or she is unable to work for more than 30 days. This product is easier for credit union staff to sell than stand-alone insurance products because it is closely associated with their core business processes. When setting up the savings account, tellers can ask whether the member wants the additional insurance coverage (Churchill and Roth, 2006).

When designing such a product, MFIs can compare the insurance cost to the cost of increasing the interest rate on savings to attract more long-term deposits. Market research by AKAM in Pakistan, for instance, showed that depositors were not very sensitive to interest rates. They were likely to be more motivated to save, or to save more over a longer contracted period of time, by a visible insurance feature attached to savings, rather than by the prospect of a slightly higher interest return. In such a case, an insurance feature is a low-cost alternative that can attract additional, diverse and long-term savings.

d) Savings to finance premiums: Many insurance products require policyholders to pay an annual premium during a specified enrolment season, which can be difficult for poor households who do not have the sufficient funds at the right time. Another way savings can facilitate access to insurance is as a premium financing mechanism. While it is quite common for MFIs to give loans to enable clients to pay premiums, an alternative is to encourage clients to save up the funds needed to pay annual insurance premiums by paying weekly or monthly instalments, which could be done by MFIs even if they are not licensed deposit-taking institutions as long as they did not on-lend the funds.

Another variation is to use interest income from clients' savings to finance the premiums. For Grameen Bank's in-house credit life cover, for example, clients have to deposit 3 per cent of their outstanding loan into a special "loan insurance savings account". Grameen uses the interest earned (12 per cent) on these savings to pay life insurance claims. Over time the insurance programme has been extended to provide the option for female borrowers to also cover their husbands by depositing 6 per cent of their outstanding loan into the account. For larger loan amounts, Grameen makes it mandatory for these borrowers to cover their spouse, as research has shown that the death of a borrower's husband is a major cause of member drop-out and delinquency. If a borrower or her husband dies during the loan period, the entire loan balance is written off and the amount deposited in the savings account and the accrued interest income are returned to the beneficiary (Dowla and Barua, 2006, pp. 98–99).

VimoSEWA, the insurance unit of Self-employed Women's Association (a trade union) in India, also applies this concept, but for a longer period of time. One of its premium financing options is to allow members to open a fixed deposit account at SEWA Bank, with a sufficient minimum

balance, and have the interest from the account pay the annual premium. This approach substantially lowers administrative costs since it is not necessary to reenrol everyone each year and premium collection costs are negligible, and it gives members the feeling that they have permanent insurance coverage. One difficulty with this approach is that clients must have enough funds to meet the minimum balance. Other complications include fluctuating interest rates and price risk from the insurers; if either changed substantially, then VimoSEWA would have to ask members to increase their minimum balances. Approximately 25 per cent of VimoSEWA's members in Ahmedabad City (where this scheme is largely promoted) use the fixed deposit account premium payment mechanism. Overall, 16 per cent of members have enrolled themselves through this mechanism, and the rest have chosen the annual premium payment mode.

2.3 TRANSITIONING FROM MANDATORY TO VOLUNTARY INSURANCE

Starting with mandatory products has advantages. It allows institutions to learn about the risks associated with its clients, such as mortality and morbidity incidence rates, without exposure to adverse selection. Since institutions do not need to focus on selling, it allows them to establish effective back-end processes such as policy administration and claims processing. MFIs can understand and address their own capacity-building requirements and refine their product and processes as needed to address operational challenges. MFIs that take the opportunity to improve these processes are better placed to introduce voluntary products.

If structured properly, mandatory products can allow MFIs to start building a culture of insurance among clients by raising their awareness. When Fonkoze expanded its mandatory cover beyond credit life, it was worried about the impact that would have on its clients, and concerned that borrowers would react negatively to being obligated to purchase insurance. In fact, the opposite occurred. Fonkoze was surprised when it noticed that its client retention was enhanced after the introduction of catastrophe insurance. In 2011, the first year of this product, the drop-out rate was the lowest in Fonkoze's history, at 10 per cent; while previously drop-out rates had ranged between 20 and 25 per cent. In branches where some clients received payouts, the drop-out rate fell to 8.7 per cent. Similarly, CARD MBA believes that a mandatory life insurance product can attract new members. In an impact survey of its products, microinsurance topped microcredit when members were asked why they joined CARD.

The problem with some mandatory products, though, is that there is no real demonstration effect if institutions do not consciously make this an objective. Since mandatory products do not require an active purchase decision from clients, they can be "sold" without properly informing clients. If field staff are not required to sell the product, they might not bother to explain the cover or might not even understand it themselves. Results from a survey of Indian MFIs, described in box 4, explain why MFIs find it difficult to transition to voluntary products.

Box 4: The challenges of providing voluntary products

A survey of 47 MFIs involved in microinsurance found that the vast majority of their products were mandatory and credit-linked and offered on behalf of insurance companies. The results indicated that MFIs found it difficult to offer affordable voluntary cover for two main reasons: (a) staff are ill equipped to advise households on risk management solutions; and (b) it consumes considerable staff time. Investing in client education and insurance sales, enrolment and premium collection was difficult for Indian MFIs whose operational models were streamlined to offer a basic loan product. Few MFIs had processes that could accommodate product diversification.

Staff who sell and service loans are ill equipped to sell voluntary insurance because the "obligation equilibrium" between the MFI and the client becomes reversed. Voluntary microinsurance involves hard selling, which loan officers are not used to doing.

Source: Ruchismita and Churchill (2012); MFI interviews

Since mandatory and voluntary products both have advantages, as summarized in table 4, a combination might be worth considering. The third microinsurance product evolution pathway (see figure 1) is for MFIs to offer a “mandatory-plus” product. In this product evolution, the basic cover is mandatory, but there are voluntary add-ons or riders that can be purchased by the policyholder. For example, a credit-linked insurance cover could have an option to add hospital cash benefits or cover spouse and family members at an additional cost (see box 5). Including this voluntary component introduces choice for clients and prompts field staff to take a more active role in providing insurance education and selling.

Table 4: Advantages of voluntary vs. mandatory insurance

Voluntary	Mandatory
<ol style="list-style-type: none"> 1. Voluntary insurance requires that the client and staff understand the product. This ensures a sufficient investment in developing the product in clear, communicable terms for marketing purposes. 2. It enables the institution to assess the demand for the product. 3. A voluntary service offers better choice to clients and it does not force them to purchase products they do not want. 	<ol style="list-style-type: none"> 1. Mandatory insurance requires a simple tracking and management system. It is easier to track insurance for all clients than to distinguish those who are insured from those who are not. 2. It reduces the risk of adverse selection. Because all clients are required to join, there is not a high percentage of high-risk policyholders. 3. It enables the insurance provider to reach large numbers of policyholders, which both allows for economies of scale and entails a higher likelihood that actual losses will track the expected losses closely. 4. Is much less expensive for customers.

Source: Adapted from Frankiewicz and Churchill, 2011.

Box 5: Microfund for Women’s Caregiver hospital cash product

In 2010, Microfund for Women (MFW), a Jordanian MFI, introduced Caregiver, a hospital cash product, in collaboration with Women’s World Banking and Zurich Financial Services. MFW started with mandatory insurance that provided borrowers with cash payments after one night of hospitalization to help offset the incidental costs of travel to the hospital, lost wages, child care and other expenses incurred during a hospital stay. Based on feedback from MFW’s clients during the product design phase, Caregiver provided benefits during hospitalization for childbirth, which was a high priority for MFW’s primarily female client base.

After the successful roll-out of the mandatory cover, MFW added voluntary cover for family members in one branch in May 2012. This component acknowledges the care-giving role that women play in their households. If a family member is hospitalized, women are likely to be away from their businesses to care for them. This product is currently being pilot tested with 450 policies issued in the first month.

Source: MFW website and MFW Learning Journey (ILO’s Microinsurance Innovation Facility, 2011) at <http://www.microinsurancefacility.org/en/learning-journey/pioneering-%E2%80%9Cwomen%E2%80%99s-world-banking-caregiver-policy%E2%80%9D-mfw-clients>

Further down this third pathway, the introduction of mandatory-plus products can be a stepping-stone towards purely voluntary insurance. Providing voluntary insurance is a way to attract new

clients who might not have been interested in the credit or savings. According to ACCION, CrediFed, an MFI in Ecuador, has members in its village banking groups who do not borrow, but only buy MediSalud, its voluntary health insurance product covering illness and work accidents. By offering voluntary insurance, MFIs can also expand their range of products and take advantage of cross-selling opportunities.

An important decision to be made when introducing voluntary products is who will be selling them. It might seem logical that if field staff or loan officers were already known in the community and interacting with the target market, then it would be cost-effective for them to also sell insurance. However this approach has not been particularly successful, in part because, as noted above, selling insurance and selling loans require different approaches. Perhaps more importantly, unless insurance sales are prioritized and incentivized by senior management and branch managers, loan officers are unlikely to give sufficient attention to insurance. This is particularly true when their core business starts experiencing problems. For example, if their portfolio at risk starts rising, they will stop selling insurance and focus on collecting loan repayments.

Such practices have been noticed repeatedly by insurance companies around the world, and have discouraged them from distributing voluntary products through MFIs. For example, in Haiti, the insurance company AIC had limited uptake of a voluntary funeral insurance product when it was sold by the employees of a local bank. But when the insurer put its own staff in the bank branches, in one month it had reached 80 per cent of the sales that the banks' staff were able to reach in a year and a half (Guarnaschelli et al., 2012). Similarly, in Indonesia, Allianz has not had much success selling a life insurance product through the MFI VisionFund, as explained in box 12.

An alternative to integrating insurance sales into the responsibilities of loan officers and tellers is for the MFI to hire specialized insurance agents. For example, UNACOOPEC, a network of savings and credit cooperatives (SACCOs) in Côte d'Ivoire serving 800,000 members, recruited 150 specialized insurance agents to distribute its funeral product, and they had sold around 66,000 policies by the end of 2011. UNACOOPEC conducted a break-even analysis to estimate the annual premium amounts for branches that would be needed to sustain the cost of the specialized agents. It estimated the product to break even at premium levels of US\$ 13,000 for SACCOs with no insurance agents (smallest branches), US\$ 37,600 for SACCOs with one agent and US\$ 79,000 for SACCOs with two insurance agents.

MFIs may find this specialization more palatable if there is a sufficient volume of premiums, but it may be harder to rationalize at the outset, creating a chicken and egg scenario: how can the MFI achieve sufficient scale without specialized insurance agents? How can it justify hiring specialized agents without the premium income to cover their salaries? An interim arrangement might be for an MFI to invite the insurance company's representatives to sell insurance to its clients, and then transition the portfolio to its own specialized staff once there is a sufficient premium flow.

Besides the additional costs, voluntary products also present a new set of risks and responsibilities for MFIs. Voluntary products enable an MFI to make itself relevant to a new market segment, but this could expose the institution to adverse selection. This is a risk even when selling to its existing client base because, while the MFI has a good sense of its clients' financial behaviour, it might not have a complete picture of their risk profile. Adverse selection is generally not a problem when the risk is spread across the entire client pool, as is the case with mandatory products. With voluntary products though, the information asymmetry is to the client's advantage. What if only the unhealthiest persons purchase a life or health insurance product? Not knowing the characteristics of prospective policyholders complicates tasks such as pricing and designing marketing campaigns.

It is not easy to succeed with voluntary insurance, but a precondition for success is the capacity to conduct market research. Knowing the target population of a mandatory credit life product is as simple as knowing the characteristics of the borrowers concerned. Offering a product that people have to choose to buy requires that institutions understand people's preferences for product features and risks covered, and have data to price the product properly. Research will also need to assess the size of the potential market, people's willingness to pay and the estimated take-up

rate in order to determine if voluntary cover makes sense. The product design process then follows, starting with discussions between the insurer and the MFI (in the partner-agent model). These give the partners the opportunity to combine the insurer's insurance expertise and the MFI's understanding of its target market. The partners can then explore ideas about how best to complement the MFI's current offering of financial products.

Voluntary products introduced by MFIs include:

Personal accident: Personal accident cover extends protection against permanent disability (for example, loss of eyesight or limbs) or accidental death. KGFS offers a personal accident product with a maximum sum assured of the equivalent of US\$ 2,000 and premium of US\$ 0.20 per US\$ 500 sum assured. Since inception in January 2009, KGFS has issued 237,515 policies. As of July 2012, 86,327 policies were active out of a total client base of 220,122, for an impressive penetration rate of 39 per cent.

Funeral insurance: Funeral insurance is a term life policy where the benefit is used to cover funeral expenses. UNACOOPEC in Côte d'Ivoire developed an insurance product with Allianz based on market research that showed that clients often borrowed to pay for the funeral of a family member. The product offers policyholders a choice of spending the full benefit on a funeral, receiving a cash payout, or a combination of the two. In the case of the latter option, the beneficiary receives a voucher to purchase the service at a funeral parlour. If the service costs less than the voucher amount, the remainder is paid in cash (Hougaard and Chamberlain, 2012). While funeral insurance is one of the most popular voluntary products, take-up is not guaranteed. In Swaziland, Select Africa has started to offer voluntary funeral cover for spouses, children and extended family in addition to the credit-life cover, but has had limited success thus far. The main challenge appears to be affordability.

Hospital cash: Hospital cash cover provides a fixed benefit amount per day of hospitalization. As illustrated in box 5, MFW in Jordan includes this cover on a mandatory basis for its borrowers, and in May 2012 added a voluntary option for clients to also enrol their families.

Hospital expenses: BancoSol in Bolivia offers two composite life and health insurance products, SolSalud and SolSalud Plus. SolSalud provides life plus basic health cover, whereas SolSalud Plus provides life, health and additional cover in case of accidents. SolSalud covers medical consultations at 100 per cent, auxiliary and maternity services at 80 per cent, and hospitalization and surgery at 70 per cent. In addition, SolSalud Plus pays up to US\$ 500 per person per year and up to US\$ 2,500 per family group per year for medical expenses in case of accidents. Anyone between the ages of 18 and 65 who has a savings account in BancoSol is eligible for this cover. No medical examinations are required. Account holders have to complete a short health declaration when they open the account. Most persons opening these accounts do so because they want savings facilities, not because they want insurance, which helps to control adverse selection. Roughly 20 per cent of new depositors – one out of every five – signs up for insurance (Churchill and Grandchant, 2008).

Coverage for migrant workers: AMUCSS, an MFI network in Mexico, has introduced a life insurance product that covers the death of the migrant and a relative in Mexico. If the migrant dies, the beneficiary receives payouts for one year as if the migrant's remittances were continuing; if the relative who acquired the product dies, the migrant receives a payment according to the sum assured (see table 5). AMUCSS also launched a repatriation certificate that can be bought by migrants' families in Mexico. If the migrant dies, his or her corpse is sent home and provided with the required funeral services. Both remittance and repatriation insurance are voluntary and not tied to any other financial products offered by the MFI. Since inception in December 2011, only ten policies have been sold. However, AMUCSS believes that the products meet clients' needs and more effort is needed to build awareness and improve distribution.

Table 5 : AMUCSS migrant insurance products

Annual premium	Sum assured (relative in Mexico)	Sum assured (migrant)
US\$ 27	US\$ 240 each month for 1 year	US\$ 1,455, one payment
US\$ 33	US\$ 364 each month for 1 year	US\$ 2,184, one payment
US\$ 55	US\$ 484 each month for 1 year	US\$ 2,911, one payment

Source: MFI interviews.

Property: Prodem FFP in Bolivia provides property insurance, Prodem Bienes, which covers the building, contents, and inventory related to the client's business. To adapt the product to its target market, the MFI persuaded the insurer not to require that buildings met minimum safety standards, which is a common exclusion in traditional property insurance. Two thousand policies are currently active. The property product is less popular than Prodem's life insurance, which has sold nearly 140,000 policies since 2009 with 49,000 policies currently active – a penetration rate of nearly 50 per cent.

Some MFIs have had difficulty in persuading insurance companies to go beyond life insurance, and to move into voluntary cover. For example in Peru, the MFI Prisma is very happy with its credit life relationship with its insurer Invita, but has not been successful in finding an insurer willing to provide livestock insurance. According to Prisma's Director, Diego Fernandez Concha, "it is cheaper to insure a Mercedes in Peru than to insure a cow". Of course cows and cars have different risk profiles so they are not really comparable, but the point is clear. Insurance companies have a comfort level with risks and markets with which they are familiar, but can be quite conservative about entering new territory.

To counter that conservatism, MFIs need to arm themselves with data. Even for a mandatory product, Prisma had to self-insure for a few years before it had enough data to persuade an insurer that "the poor don't die like flies". How big is the potential market? What are the incidence rates of the risks identified? What is the willingness to pay of prospective policyholders? Such data may help insurers to design a product that might be relevant. But if they are still reluctant, MFIs might consider having conversations with reinsurers or reinsurance brokers who may have additional data and be familiar with similar products in other countries, and could potentially support local insurers. Select Africa loudly applauds its reinsurance broker, Guy Carpenter, for enabling it to find an appropriate solution.

Starting microinsurance with voluntary products can be challenging, especially given the need to achieve scale to be sustainable. Take-up rates for voluntary products are often quite low, especially during the initial periods, before the market has an opportunity to see that claims are indeed being paid. According to ACCION, Banco Ademi in the Dominican Republic introduced a multi-risk product covering health, accidents, life and some damages at the workplace, while Fama in Nicaragua introduced a funeral product. Both products were introduced as voluntary cover, but the MFIs struggled to reach scale. In 2012, Ademi had 14,000 insurance clients (11 per cent penetration) while Fama had 4,500 policyholders (12 per cent penetration). They are now considering making the products credit-linked, which will enable them to cover more clients and lower the premium.

An MFI that wants to offer to voluntary insurance needs to consider its product evolution pathway carefully. Perhaps it is better to start with simple, mandatory products (that are still relevant for the market) and develop expertise and capacity before introducing more challenging voluntary products. Providing voluntary products (even if the MFI only acts as an agent for an insurer) requires the MFI to build internal capacity, which includes setting up an insurance unit or team and acquiring specialized competencies to market, sell and service the products.

The provision of voluntary insurance is not suitable for all MFIs. With slow growth and penetration

rates, often in the 10 to 20 per cent range, purely voluntary offerings can be more trouble than they are worth. But an MFI that is interested in reducing the vulnerability of its clients should consider voluntary insurance as part of its long-term strategic objectives.

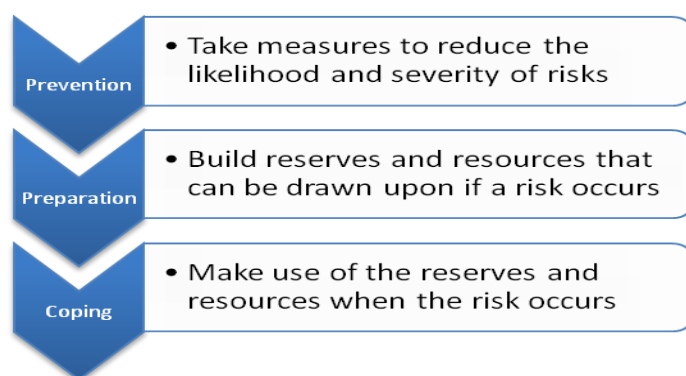
2.4 PACKAGING INSURANCE WITHIN A RISK MANAGEMENT FRAMEWORK

When MFIs offer insurance, it is important that it complements their existing offerings. This fourth pathway for product evolution comes naturally with savings- and credit-linked cover, but to increase the potential impact of insurance, it is necessary to take a more holistic view of the clients' risk management needs, and design a package of financial and non-financial services that can address them appropriately.

As highlighted by Zeller and Sharma (2000), "A large share of [poor] households borrow, many more save, and all seek to insure against the vagaries of life." In this case, the authors use a broad definition of "insure" meaning to protect against risk, but not exclusively using the risk pooling mechanism of insurance. Indeed, insurance is an appropriate financial instrument to protect against large losses that occur infrequently. To provide more comprehensive protection, MFIs can couple insurance with savings and emergency loans to help clients to manage small and frequent losses and economic stresses.

In fact, a comprehensive approach requires other interventions besides financial services. According to Arman Oza, the Chief Executive Officer (CEO) of VimoSEWA, a microinsurance intermediary in India, "apart from insurance which is a function of risk transfer, any activity aimed at enabling risk retention, risk control or risk avoidance, contributes to the larger goal of community risk management (CRM). Apart from the social benefits of CRM, an improved risk profile of the community over a period of time is bound to offer business gains for the MFI in terms of up-selling of microfinance products. Because core insurance products are only going to directly benefit a minority of the insured population, such risk management initiatives also help by providing tangible benefits to a larger cross-section of insured populations and thereby enhance client value."

Figure 4: Risk management framework: Three phases of activity



A risk management framework could include three main categories of activities – prevention, preparation and coping – as illustrated in figure 4. For **prevention** activities, it is necessary to first understand what risks the target markets are most vulnerable to, and of those, which ones could be prevented. Many health risks are preventable through improved sanitation, hygiene and nutrition, so one way to manage that risk is through education and awareness-raising. For example:

- At Grameen Bank group meetings, members recite the 16 decisions, which include growing and eating vegetables, boiling drinking water and using pit latrines.

- Through SAJIDA's community health programme, "health mobilizers" visit clients to provide basic primary health-care services. They discuss health issues with people and conduct basic diagnostic tests. To prevent malaria, SAJIDA offers educational activities to promote early detection and treatment, and provides insecticide-treated bed nets to high-risk groups, such as pregnant women and young children.
- Similarly, MFIs working in environments with high rates of HIV infection often promote condom use and encourage testing. Such approaches can have a significant impact. For example, the training offered to its members by the South African MFI Small Enterprise Foundation (SEF) on gender roles, sexual violence and HIV prevention has resulted in a 50 per cent decrease in violence experienced by women within the family and a significant decrease in risky sexual behaviour that might lead to HIV infection (Simanowitz, 2008).
- SEWA, through its sister organization SEWA Health Cooperative, provides health education on disease prevention and sanitation to its members.

Such prevention activities do not have to be limited to health issues. Fonkoze in Haiti plans to encourage better risk mitigation among clients to complement its disaster cover (see box 8 for details of the latter). It will encourage simple changes, such as using watertight, floatable containers to store merchandise, to reduce losses for clients and Fonkoze during natural disasters.

While such activities may seem to be beyond the scope of a financial service provider, it depends on one's perspective and objectives. For MFIs with a strong social agenda, like SEF, Fonkoze, SEWA and BASIX (see box 6), risk prevention is certainly within their mandate. However, even commercially oriented MFIs might justify such intervention because of its potential to decrease claims, increase client loyalty, improve portfolio quality, and differentiate the MFI in the market. As Benjamin Franklin said, "an ounce of prevention is worth a pound of cure"; for MFIs, small investments in prevention activities may pay big dividends.

Box 6: BASIX helping clients with risk mitigation

In 2002, after five years of operation, BASIX, an Indian MFI, hired an external agency to conduct an impact assessment of its microcredit operations. The study's findings were not very positive: 52 per cent of BASIX's clients had experienced an increase in income, 23 per cent reported no change, while 25 per cent actually were worse off. Based on this analysis, BASIX's management recognized the limitations of a minimalist microcredit approach. Besides credit to stimulate livelihood activity, borrowers needed access to markets and assistance in managing risks.

Consequently, BASIX introduced an integrated service delivery approach that combined agricultural and business development services and livelihood financial services to boost incomes and mitigate clients' exposure to risk. Through its Agriculture and Business Development (Ag/BDS) Services, BASIX offers a number of non-financial services that provide risk prevention mechanisms for arable and dairy farmers. Farmers can buy a yearly contract of Ag/BDS services that is not linked to loans. Through the contract, farmers get advice on selection of new crops, seed treatment with fungicides, and pesticides. For dairy and livestock farmers, risk mitigation services include advice on new breeds, vaccination, de-worming, first aid and sanitation.

BASIX has seen a high satisfaction and contract renewal rate for its Ag/BDS services. The general idea is to enable people to avoid risks where possible. Insurance products are then offered to act as a risk transfer mechanism for risks that cannot be mitigated.

Source: MFI Interviews.

It is also possible for MFIs to improve access to services without providing the services themselves. For example, CARD's Preferred Provider Program enables clients to access a range of discounted services from private health-care providers. Through the programme, CARD is giving its clients expanded primary-care options in their communities without being involved in the direct provision of these.

The second step in the risk management framework is **preparation** through the accumulation of capital, building reserves and resources that can be drawn upon if the insured event occurs. This is where financial services fit in, but there are other types of "capital" that can also play a critical role, as summarized in table 6

Table . MFIs can naturally assist their clients to accumulate financial capital, but some also work on the other dimensions. For example, MFIs that use group lending methodologies assist in the formation of social capital. Many MFIs have education savings accounts or offer school loans to support the development of human capital. They may also provide skills training and business development services, for example through a credit with education approach. Some even have safe deposit boxes to help protect their customers' physical capital; while others offer pawn loans to turn physical capital into financial capital.

Table 6: Types of capital contributing to risk management

Type of capital	Contribution to risk management
Financial	<ul style="list-style-type: none"> • Budgeting and financial planning • Building up cash savings • Purchasing insurance products • Maintaining credit history and establishing access to credit lines
Physical	<ul style="list-style-type: none"> • Assets, e.g. livestock, consumer durables, jewellery
Human	<ul style="list-style-type: none"> • Educating children • Learning new skills
Social	<ul style="list-style-type: none"> • Joining ROSCA¹ or mutual aid society • Helping friends, relatives in times of need

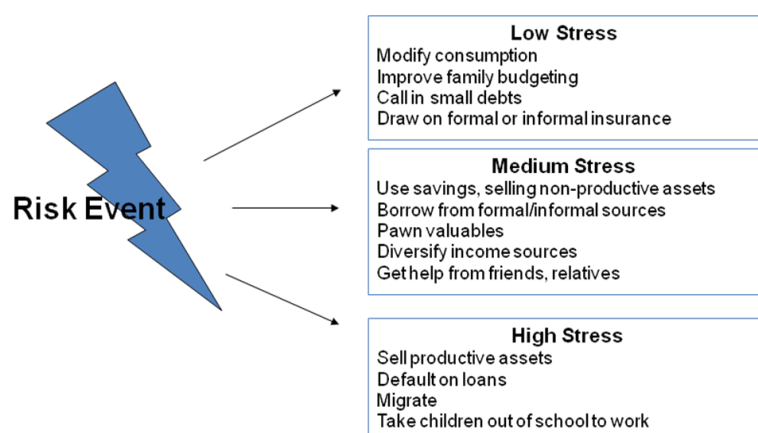
¹ Rotating credit and savings association.

Many microfinance institutions are reluctant to offer consumer loans since they are generally not used for productive purposes, and can therefore represent a credit risk unless the household has another source of income to pay the loan back. Some MFIs disapprove of consumer loans because they do not believe that they contribute to their social agenda. However, an examination of consumer lending within a risk management framework may help to improve its reputation for two reasons. First, if consumer loans are used to purchase household goods and durable consumer items, this physical capital could be liquidated if there were a crisis. Second, the methodology of offering and managing consumer loans is essentially the same as one would use for emergency loans, so the provision of consumer loans may enable MFIs to provide effective emergency loans. KGFS, for example, evaluates debt-servicing capacity at a household level by taking into account all income sources. Loans for either consumption or emergency purposes are then disbursed on the basis of this analysis.

The third category in the risk-management framework is **coping**, which is essentially putting in place or operationalizing the preparation activities. Sebstad and Cohen (2000) identify three categories of coping activities that have different levels of impact on households and enterprises, as summarized in figure 5. From a risk management perspective, the objective is for MFIs to facilitate consumption smoothing by enabling clients to rely on low and medium stress coping

mechanisms, and to avoid high stress solutions as these create a downward spiral into chronic poverty.

Figure 5: Ways of coping with risk



Source: Adapted from Sebstad and Cohen (2000).

6) APPLY HOLISTIC RISK MANAGEMENT

To achieve that objective, MFIs can offer a set of risk-managing financial services that support efforts to rely on low and medium stress coping mechanisms. Besides insurance, these products might include:

- **contractual savings** for future expenses that are expected, such as school fees and religious ceremonies, so that households can save up money for them;
- **emergency loans** that allow clients to cover small expenses and smooth consumption, although these need to be managed carefully to avoid over-indebtedness;
- **combination products** that allow households to turn assets or equity into cash. For example, rather than drawing down on a targeted savings account during a time of need, people on low incomes might prefer to borrow using their accumulated savings as collateral.

Although savings are the most cost-effective means of managing small risks, the poor often prefer to borrow when faced with an economic shock rather than deplete their nest egg (Sebstad and Cohen, 2006); hence the importance of offering a range of possible financial solutions. Box 7 gives an example of a financial institution that adopts this holistic approach to risk management and household growth, by providing a range of financial and non-financial services.

Box 7: KGFS's wealth management approach

The KGFS model provides tailored financial advice to every enrolled client. This "wealth management" approach, to adopt a term common in private banking, ensures that clients understand their cash flows, identify avenues of growth, manage risk and deploy surplus appropriately, and thereby promotes the financial well-being of the households. The model is based on the belief that clients will make better choices among complex financial services when they have advice from trained professionals. Advice is grouped into four broad categories based on an analysis of the client's cash flow, assets, liabilities and goals (short term as well as long term):

1. **Plan** using tools that help people manage short-term liquidity needs, allowing them to deal with variability in their cash flow. These include savings, money market investments, short-term loans and payments services.

2. **Grow** through financial products that allow households to increase income or reduce expenses, which include working capital loans for businesses, higher education loans for students, and refinancing debt.

3. **Protect** by using products that mitigate risk such as life, accident, health, enterprise and livestock insurance, along with advice for other suitable insurance. Through these products, KGFS aims to help households develop an effective risk management strategy.

4. **Diversify** through investment instruments that help achieve inflation protection and offer better risk-adjusted returns. Products such as pensions and equity-index funds can help households diversify their assets away from land or livestock towards assets that are better protected if the local economy hits a slump.

Source: Adapted from Ananth et al., 2012.

2.5 CONSIDERING MESO-LEVEL SCHEMES FOR DISASTER PROTECTION

The fifth pathway of microinsurance product evolution involves protection from disasters. In many countries, MFIs and their clients are vulnerable to disasters, including floods, hurricanes and earthquakes. Because of climate change, many of these risks are increasing. Not only is this a major danger for low-income households, but because it is a covariant risk, which means that it affects many clients at one time, a catastrophe is a serious threat to the MFI's solvency. For example, floods in Bangladesh have repeatedly damaged the households and livelihoods of the working poor, and therefore threatened the loan portfolios of several MFIs. To recoup these losses, MFIs often have to be recapitalized by donors, and then reschedule and/or refinance loans, and provide relief services to help borrowers get back on their feet and resume their income-generating activities. But would insurance be a more efficient means of managing such a risk? It certainly has the potential to be a more sustainable and responsive solution than for MFIs to ask for disaster donations.

Insurers deal with covariant risks through diversification and reinsurance. MFIs that can spread their risk pool across different geographical areas and markets have a better chance of managing covariant risks. However, as far as reinsurance is concerned, since MFIs are not formal insurers, they cannot access the reinsurance market directly. Consequently, to access protection against disaster risks, MFIs need to link up to the insurance industry in some way.

For covariant risks, it does not make sense to consider protection at a personal or household level, but rather to have coverage for an MFI's overall portfolio. Such meso-level schemes are beginning to emerge to deal with catastrophe risks. For example in Haiti, the devastating hurricane season in 2008 pushed the MFI Fonkoze to look for financial protection for itself and its 50,000 borrowers against natural disasters. With key partners, including Swiss Re, it formed Microinsurance Catastrophic Risk Organization (MiCRO) in 2011 to provide index-based protection to Caribbean MFIs (see box 8).

Box 8: Meso-level catastrophe protection

MiCRO is a registered reinsurance company that provides index-based protection to MFIs, which means that the payout is not based on the damage that actually occurs, but on a measurable indicator such as wind speed, rainfall or seismic activity. When the index is triggered, the reinsurer Swiss Re pays a pre-defined benefit to the MFI. The MFI then extends benefits to its clients based on their actual losses. If there is basis risk – if the index-based payout is not sufficient to cover the clients' actual losses – then MiCRO covers the difference, up to US\$ 1 million per year.

The first MFI protected under this scheme, Fonkoze in Haiti, reimburses affected clients' outstanding loans and pays each a lump sum of 5,000 Haitian Gourdes (HTG) (approximately US\$ 125) in the case of a natural disaster. Fonkoze charges clients 3 per cent of the loan as premium, although the product costs 5 per cent, and the difference is currently subsidized by Fonkoze and donors. For a payout to occur, one of three criteria must be met:

1. More than 50 per cent of merchandise is lost as a result of the event.
2. The home (place of residence) is damaged to the point of not being habitable.
3. The place of business is damaged to the point where operations are no longer possible.

The first claim occurred in 2011 after extended rains caused significant damage. This resulted in a payout of US\$ 1.05 million to Fonkoze, which then assessed its clients' damage and paid US\$ 1.03 million to 3,800 clients, including loan write-offs. Early indications show that borrowers are very happy with this product and anecdotally it has been suggested that the product might even be a means of attracting new borrowers to the MFI.

Source: MFI interviews; Loster and Reinhard (2012).

A similar solution was launched in 2011 by the cooperative insurer CLIMBS in the Philippines, together with Munich Re. CLIMBS is a composite insurance company, so it can offer both life and non-life insurance to its more than 2,000 member cooperatives, many of which are savings and credit cooperatives. In the event of natural disasters, the reinsurer provides an index-based cover to protect CLIMBS' member cooperatives against loan defaults by clients. When the weather event occurs and the related rainfall or wind trigger is reached, CLIMBS makes a payout to the cooperatives, based on the index. The payout is not based on individual loss adjustments; each cooperative receives a pre-defined percentage of its loan portfolio. Unlike Fonkoze, which pays benefits to borrowers, the cooperatives use the funds to make emergency loans to the affected borrowers to help them recover from their losses (Loster and Reinhard, 2012).

In another example, GlobalAgRisk is developing a product to counter the threat of El Niño. El Niño is a recurring threat in Peru, and brings catastrophic flooding along its northern coast. Feasibility assessments showed that the consequences of El Niño were a major constraint on agricultural lending. To reduce this constraint, GlobalAgRisk created an index insurance product, which uses the temperature of the surface of the Pacific Ocean as the basis of payment. These temperatures are considered correlated with and predictive of the extreme El Niño events that affect agriculture. This is quite unique because it could increase agricultural lending while enabling MFIs to help clients prepare for the effects of El Niño before it happens. Such innovations are an exciting development to protect MFIs from catastrophe risks; but as with their clients, it will take time before MFIs appreciate the benefits of such cover.

The various product evolution pathways described above illustrate the different options available to MFIs. While the pathway or pathways chosen by the MFI depends on its strategic vision and objectives, certain overarching principles apply: MFIs, whether commercially or socially motivated, need to take a holistic view of their clients' risk management needs and design a package of financial and non-financial services that can address their needs appropriately. They should be proactive in assessing how insurance can address the needs and preferences of the target market. Products that increase the chances that the poor can witness the benefits of insurance will enhance the process of creating a culture of insurance. Even with mandatory cover, MFIs need to make sure that clients know about the coverage and appreciate the benefits. The final stage of product development is as important as the previous ones: before rolling out products on a large scale, it is critical to pilot test them first, in order to validate the product design and streamline operational processes.

3 > THE RANGE OF INSTITUTIONAL OPTIONS

Financial institutions typically offer insurance through one of four basic institutional arrangements, as summarized in table 7, although there are a number of variations and hybrid structures as well. Each model offers varying levels of control over the product and processes, as well as different administrative responsibilities. The models also offer different levels of risk exposure and consequently varying opportunities for rewards. The selection of an institutional model is based on a number of factors, including an MFI's strategic objectives for its insurance initiative, its internal capacity to manage insurance operations, the availability of suitable insurance partners, and the regulatory environment.

These institutional options are not static. Just as the insurance products offered by MFIs evolve over time, organizations may also move from one institutional model to another, based on experience and objectives. MFIs may decide to change models, based on a variety of factors, including new regulations, pressure from regulators, dissatisfaction with existing products or partners, desire to retain greater insurance profits, or the need to have more control over product design or claims processing.

Table 7 : Institutional models

	Self-insure	Partner-agent model	Work with an intermediary	Create an insurance company
Makes sense for:	<ul style="list-style-type: none"> • Simple risks • Large client base 	<ul style="list-style-type: none"> • Starting microinsurance operations • Building in-house expertise • Complex products (if insurers are willing) 	<ul style="list-style-type: none"> • Early stages of programme • MFIs that do not want to develop in-house expertise • Complex products 	<ul style="list-style-type: none"> • Large MFIs or networks • Regulatory compliance • Jurisdictions with low capital requirements
Advantages	<ul style="list-style-type: none"> • Flexibility and control • Cost-efficient • Potential for greatest returns 	<ul style="list-style-type: none"> • Partner brings insurance expertise • Limited risk exposure 	<ul style="list-style-type: none"> • Additional servicing and support • Broker understands how insurance companies think • Contacts with insurers 	<ul style="list-style-type: none"> • Flexibility to work with different partners • Retain profits • Can offer more complex products
Challenges	<ul style="list-style-type: none"> • Riskiest option • Capital and reserve requirements • Regulatory restrictions and questionable legality • Capacity constraints • Complex products • Covariant risks 	<ul style="list-style-type: none"> • Reputational risk if partner does not deliver • Revenues are divided 	<ul style="list-style-type: none"> • Another mouth to feed in the value chain 	<ul style="list-style-type: none"> • Involves risk • Capital requirements • Insurance expertise

3.1 SELF-INSURING

As outlined in section 2, most MFIs start their insurance operations with credit life or mandatory life products. Some MFIs choose to manage such products in-house by creating a reserve fund. When a client dies, the loan balance is written off and deducted from the fund. The fund can also be used to cover loan losses that are associated with other risks. Typically MFIs choose this option because they want to provide certain protection to clients, are unable to find a suitable insurance partner, want to simplify processes and maintain greater control over operations, and/or retain profits from the product.

In general, the main drawback to self-insuring (besides the fact that it may be illegal) is the limited range of products that can be offered. Self-insuring may be a suitable option for straightforward risks like death (although even this has to be assessed properly), but becomes inappropriate as risks get more complex, especially since MFIs are unable to access reinsurance. As described in Churchill and Roth (2006), the preconditions for self-insurance include the following.

1. The MFI has a large enough risk pool, at least 10,000 insured lives covered, and the risks are reasonably homogeneous.
2. The product is kept simple.
3. The MFI obtains catastrophe coverage from an insurance company.
4. The MFI makes use of appropriate technical expertise with product design, pricing, data management and performance monitoring.
5. Regulators allow it.

Many MFIs do not have the capacity to self-insure, and certainly do not have the expertise to price products accurately. Consequently, one often sees an MFI that sets a conservative premium rate, builds up a sizeable reserve fund, and then decides to offer additional benefits without assessing the underlying risk. As a result, the reserve fund is quickly depleted, and the MFI has to re-price the product or lower the benefits, which can undermine the trust that clients have in insurance, the MFI, or both.

Many MFIs in Bangladesh manage insurance in-house. For example, SAJIDA Foundation's insurance scheme was borne out of its motivation to provide health care to its microcredit clients. Through this scheme, SAJIDA aims to provide quality health care that is conveniently accessible to its clients. The health insurance provides benefits in case of hospitalization, and clients can access health services at SAJIDA's hospitals and clinics at discounted prices. Clients can also access services at other hospitals, for which they can claim fixed cash benefits based on a list of health procedures. SAJIDA retained the risk in-house to have greater control over product design and operation. For example, for claims processing, Sawsan Eskander, Head of Product Development at SAJIDA, explains, "Since we are self-insured, we have the flexibility to make exceptions when we know that the claim is valid, even if clients do not have the documentation that the insurer would require."

MFIs that self-insure need to set aside appropriate reserves, as determined by an actuary, and invest them prudently, which generally means not in their loan portfolio. It might be tempting to tap into the insurance reserves, especially if the MFI is experiencing liquidity constraints in other parts of its operations. However, insured risks do not occur regularly, so reserves should be maintained separately so that the MFI can pay claims quickly if the insured event does occur.

There may also be regulatory constraints that prevent MFIs from self-insuring, particularly for regulated MFIs, since the banking superintendent would not look favourably at insurance risk on their balance sheets. Insurance supervisors may not pay close attention to an MFI's self-insurance scheme as long as the benefits and scale are limited. In fact, in Ethiopia, MFIs are actually authorized to manage in-house insurance schemes. However, in environments where self-insurance gets out of hand and threatens to undermine confidence in insurance (or insurers complain about unfair competition), then supervisors may require MFIs to off-load the risk to a regulated entity, as has happened in the Philippines.

Some MFIs have moved into and out of self-insurance depending on their relationship with insurers and their claims experience. It also is common to find hybrid approaches, where an MFI manages a credit life or credit life plus scheme in-house, which helps it to develop insurance expertise, but outsources more complicated risks to an insurance company. For example, in Pakistan NRSP manages its credit life cover for its urban microcredit scheme in-house through a 1 per cent surcharge on all loans, which is accounted for separately in its financial statements. However, NRSP's rural development programme also provides compulsory family hospitalization cover, which is underwritten by Adamjee Insurance.

3.2 PARTNERING WITH AN INSURER

Perhaps the most common way MFIs provide insurance is through the partner-agent model, where the MFI acts as a distribution channel for an insurance company. The MFI provides access to its client base and performs specific roles in the delivery of insurance, and it is generally compensated for these efforts through commission or service fees. The MFI typically does not carry any risk, but can provide its clients with a valuable service while generating an additional source of revenue. In more complicated partnership structures, the risk and reward sharing is integrated, with the MFI sharing the profits of the insurance offerings, although in some countries regulation may prohibit this arrangement.

According to Rendek (2012), the most successful microinsurance partnerships appear to be those that:

- have a strong alignment of interests and objectives, where the microinsurance programme contributes to the core business of each partner;
- approach the initial phase as a time for learning, with a long-term commitment to developing sustainability;
- set realistic goals and expectations through a joint process;
- clearly delineate roles and responsibilities;
- collaborate at some level in all areas of programme development and implementation;
- are flexible, especially around problem solving and change.

The key to this model is finding an insurance partner whose interests are aligned with those of the MFI. For Fonkoze in Haiti, an alignment of mission with the insurer was essential. Fonkoze believes that this alignment has to be present at the top level of both partners, and needs to permeate the organization. When Fonkoze's insurer AIC approached it to explore collaboration, Fonkoze was only convinced once it saw that AIC understood and shared its "social conscience".

MFIs search for insurers that are willing to be committed to the low-income segment for the long term. But how can they assess this commitment? One way is to determine whether the insurer is willing to modify its business processes to meet the needs of microinsurance clients. Adjusting processes is more cumbersome than adjusting product pricing or benefits, and takes more effort by the insurer; hence insurers are only willing to go through this exercise if they plan to be in the partnership for a long time.

When BASIX was selecting its insurance partner, for example, it considered price, awareness of the market segment, and willingness to change processes. This third criterion was the most important for the MFI because it wanted a partner that was willing to understand and accommodate the circumstances of the poor. Royal Sundaram, BASIX's general insurer, demonstrated its commitment by adapting its business processes for livestock insurance by not requiring veterinary surgeons to issue a health and valuation certificate at the enrolment stage. This practice is expensive and inconvenient for the poor as vets are not always available in rural areas and their fees can be equivalent to 50 to 60 per cent of the annual premium. To reduce costs and, consequently, the premium, BASIX used its own field staff to assess the cattle's health and value. Since staff were not necessarily skilled in this area, BASIX and the insurer invested heavily

in training. The partners assumed that even if BASIX's staff made errors, the benefits of this solution would outweigh the costs, especially when considering that the veterinary services were fraud-prone and of low quality (Sharma and Mude, 2012).

MFIs should not hesitate to switch insurers if they are unhappy with the service delivery or if the insurer is not sufficiently able to meet the needs of the MFI and its clients. However, partnerships should be sought with a long-term perspective. Focusing on a lower premium rate or higher commission might be advantageous in the short term, but “partner churning” can be administratively costly and make it difficult for the insurer to trust the MFI and commit to the programme. It can take a while for insurers to understand the market well enough to be willing to innovate and try new products or agree to better terms.

BASIX recommends that MFIs should not push insurers to offer products at low rates in the beginning. Products need to be sustainable, and it is better to wait until partners have better data on the market before lowering the price or improving benefits. Both parties need to have space to experience failure, which can be achieved by committing financial and human resources beyond a pilot phase.

One way to retain commitment from partners is to outline specific learning objectives and then measure progress towards them during the initial stages of a partnership. A pilot can be designed to test different product features, premium levels, staff incentives or communication materials. It can also assess the effectiveness of the enrolment and claims processes. The initial objectives can then focus on understanding the factors that will lead to a successful programme, rather than only on specific performance indicators such as sales or claims numbers. In such a learning partnership, continued commitment depends on recognizing the learning that has taken place, even when financial progress appears to be incremental (Rendek, 2012).

A partnership that works closely and efficiently can reduce costs and increase client value. Long-term partnerships allow the parties to trust each other more and improve their product offering over time. By integrating data systems, information can be more easily shared between partners and monitored by the MFI. Establishing this integration also provides an incentive to continue with the partnership.

For example, the Bolivian MFI Prodem FFP had worked with Nacional Vida for a long time on its credit life insurance. As the relationship between the organizations was excellent, Prodem decided to explore the possibility of developing voluntary microinsurance products. Discussions with other insurers demonstrated that they did not have the same openness and flexibility as Nacional Vida. Nacional Vida was willing to collaborate with the MFI to design the products, although it took almost two years of persuasion from Prodem. The MFI refers to the partnership as an “institutional marriage”. Through their commitment and the high level of effort put into the programme, the two organizations are now able to resolve difficulties quickly.

The partner-agent model makes sense for the majority of MFIs. It works well especially at the initial stages when MFIs are developing an understanding of insurance and building in-house capacity. But MFIs do not always get what they want from the insurer, so even within the partner-agent model one finds hybrid approaches whereby an insurer provides the basic coverage, but the MFI provides additional benefits. For example, in addition to the core insurance benefits offered by its insurers, VimoSEWA offers coverage for hearing aids (US\$ 20), dentures (US\$ 12) and maternity (US\$ 6) to members who pay their premiums through the fixed deposit method (see section 2.2).

3.3 WORKING WITH AN INTERMEDIARY

An intermediary or broker who is knowledgeable about the low-income market can be useful to MFIs starting their microinsurance operations. Brokers often have existing relationships with insurance companies that can be helpful when looking for potential partners. The broker's knowledge of insurance is useful during product design and negotiations with the insurer. Often brokers help build expertise within the MFI by providing insurance training, although some MFIs might work with brokers because they do not want to assume various insurance functions.

Some intermediaries have expanded beyond the traditional broker function of matchmaking to serve as market makers (Bernhardt et al., 2012), helping distribution channels, such as MFIs, to identify the unmet needs of their clients and to develop products and processes, and providing services such as policy administration and claims processing. For example in the Philippines, the microinsurance broker MicroEnsure supports insurance services offered by ten MFIs covering nearly 2 million people with a selection of life, health, accident and disaster products. These MFIs chose to collaborate with MicroEnsure, instead of approaching the insurers directly, because MicroEnsure was committed to high service standards and could support product evolution.

During the initial stages of microinsurance development, working with a broker can help the MFI be in a better negotiating position when building relationships with insurers, as described in box 9. However, AMUCSS' experience also highlights the main limitation of microinsurance brokers. An intermediary adds another mouth to feed along a value chain that has very limited (or non-existent) profit margins to go around. The option only makes sense if the added costs are offset by the benefits of the broker's expertise and a better negotiating position for MFIs.

Box 9: Benefits of using brokers in Mexico

AMUCSS, a network of 30 rural banks and savings and credit cooperatives, has sold 165,000 life insurance policies since 2006. It began offering insurance with products designed by the broker Grupo SEP and underwritten by Zurich Mexico. Grupo SEP had the contacts and business relations with insurance companies, and was knowledgeable about product design and pricing for insurance risks. Grupo SEP also had experience marketing to the low-income segment, and could share its effective administration process with AMUCSS. It served as the coordinating partner throughout the negotiations and product design phase, and acted as the intermediary by collecting the policy and claims data from AMUCSS and providing details to Zurich Mexico. As an intermediary under Mexican insurance regulations, Grupo SEP's role was broader than that of a broker, and involved the administration of insurance policies on behalf of Zurich Mexico, including paying claims.

After four years of working through a broker, AMUCSS decided to establish a direct partnership with Zurich Mexico as it believed it had the capacity and expertise to perform all the functions. AMUCSS believes that Grupo SEP's involvement was necessary in the initial stages as AMUCSS would have struggled to manage the relationship with Zurich Mexico, and could not have obtained the same service and benefits from the insurer without the broker.

In 2010, AMUCSS created its own brokerage, RedSol, which was responsible for all its insurance-related activities. This option makes sense for networks of MFIs that want to consolidate their insurance activities into one unit. In this model, the insurance company still carries the risk and the MFI acts as the distribution channel, but all the administrative duties are outsourced to the brokerage. As the brokerage is able to specialize in these activities, it should lead to greater efficiencies. Through this option, institutions can also combine their buying power and gain leverage when negotiating with the insurer. This option works best for a network where institutions are not direct competitors.

Source: MFI interviews.

The involvement of brokers might also depend on the complexity of the product. Perhaps with basic products, many MFIs can manage the relationships with insurers directly or even self-insure, but with more sophisticated cover it may be useful to involve an intermediary. For example, MFIs interested in introducing an index-based insurance product will not have in-house

expertise, nor are they likely to find it at the insurance company. In India, the weather-index insurance sector has taken off, in part because of the emergence of a specialized intermediary, Weather Risk Management Services (WRMS), that can design products and indices, and bring insurers to the negotiating table. WRMS helped launch the market, not just by facilitating contact between insurers and delivery channels, but also by digitizing data from non-automated weather stations and developing the risk models necessary for product design (Bernhardt et al., 2012).

The business case for microinsurance-only brokers in the long term is as yet unproven and financial institutions need to think carefully about the costs and benefits of this option. An important consideration is whether MFIs want to invest in their own microinsurance expertise and build knowledge themselves. Working with an intermediary can help the MFI test the market. However, MFIs should make sure that they are able to change their strategy in the future, including moving their business to another intermediary or working directly with the insurer.

3.4 CREATING AN INSURANCE COMPANY

The final option is for MFIs to create their own insurance company. The motivations for this option are similar to those for self-insuring, except that the company would comply with insurance regulations and enable the MFI to expand its product offering to more complex types of cover. MFIs with large self-insurance operations might choose this option once their exposure becomes too great and it makes sense to create a separate legal entity to manage the insurance business. Given the capital requirements for forming an insurance company in some countries, this option may only be available to large institutions or associations of smaller ones, but can be a challenge even for them. SEWA has been interested in creating its own insurance company for years, but the capital requirements in India are in excess of US\$ 20 million, and the trade union has not managed to persuade the Insurance Supervisor to give it an exemption. In Swaziland, the capital requirement is quite low, around US\$ 250,000, which created an opportunity for Select Africa's parent company, African Alliance, to create an insurance company with the MFI as its first client (see box 10).

Box 10: Creating an insurance company in Swaziland

Select Africa, a microlending company owned by the African Alliance Group, operates in several African countries. Its largest loan portfolio is in Swaziland, with more than 20,000 borrowers. It lends mainly to salaried workers on low incomes, and the unsecured loans are primarily used for home improvements, including installing solar-powered lighting and rainwater harvesting, which allow its borrowers to build their assets.

Over the years, Select had worked with several insurance companies for its credit life coverage, and had good experience with claims servicing, but when it looked at the figures, at the premiums collected and the claims paid, it realized that it was a very profitable client for the insurance companies. With initial guidance and advice from a reinsurance company that was situated in a neighbouring office, Select's management realized that the best solution was to create an insurance company within the African Alliance Group that could service the MFI's portfolio and then expand to other clients. African Alliance may replicate the model in other countries where it has a sizeable loan portfolio if the regulatory and market conditions are amenable.

Since Select did not have any insurance expertise, it was grateful to its reinsurers, Swiss Re and Munich Re, and especially to its reinsurance broker Guy Carpenter, for taking it through the process of creating the insurance company, Orchard Insurance. And to ensure that it had at least one "captive" channel besides Select to distribute insurance, it also invited the largest SACCO in Swaziland to be a shareholder in the new company.

As affiliated companies, Select and Orchard can work together to develop new products that might be appropriate for Select's clients, potentially including health and property insurance. However, before progressing towards complex types of cover, the first move beyond credit life is a voluntary funeral product.

Source: MFI interviews.

SANASA, a network of credit cooperatives in Sri Lanka, has also created its own insurance company – two in fact – to cover the risk protection needs of its 8,400 cooperatives and their 3 million clients. Insurance schemes provided by the cooperatives started with informal schemes such as funeral aid societies. Over time this grew to the point that the SANASA federation wanted to professionalize the operations and create an insurance company owned by the cooperatives. SANASA established the SANASA Insurance Company Ltd (SICL) in 2002 with a share capital of 25 million Sri Lankan rupees (LKR) (US\$ 188,600) to operate life insurance business and subsequently, the share capital was increased to LKR 75 million (US\$ 565,800) to expand to general insurance. Today the capital requirement imposed by the regulator amounts to LKR 1,000 million (US\$ 7.4 million), and SANASA has a grace period of four years to raise the funds.

In some countries, including the Philippines, the regulatory environment has a special tier that may be more conducive to microinsurance because it has fewer technical and financial requirements for simple products. For example, CARD has established an MBA that provides death benefits and long-term savings for retirement, protecting more than 7 million low-income Filipinos through its rural bank and microfinance NGO. In keeping with the institutional culture, CARD MBA actively involves members in the management of the association, which includes establishing policies and procedures to strike a balance between institutional sustainability and improved client value. Once the MBA has accumulated sufficient capital, it intends to create a fully fledged insurance company, which can provide more comprehensive services. In preparation, CARD MBA is now enthusiastically training its staff and agents, as well as its Board of Trustees.

The main challenge with this model is meeting the regulatory requirements, which are quite onerous in some jurisdictions, including significant insurance expertise and sizeable capital outlays. MFIs that are serious about insurance may see some value in moving incrementally towards this model. This might justify first going through different variations of the partner-agent model whereby the MFI assumes greater roles and responsibilities for insurance over time, and therefore becomes better equipped to spin off the insurance operations into a separate company.

Because raising share capital can be a major challenge with this institutional option, where there is not a lower tier option, an alternative is for the MFI to provide insurance through a cell captive or protected cell company. An MFI can form a cell captive by buying shares in an insurance company to “create a captive” or paying fees to the insurance company to “rent a captive”. Through a cell captive, the MFI can use the licence of the insurance company to provide products and participate in the profits and losses. A cell-captive approach may make sense for large financial institutions or a network of institutions that have access to a large number of policyholders.

Cell captives are common in South Africa. In the microinsurance sector, the South African insurance company Hollard has created a cell captive with MicroEnsure. The partnership allows MicroEnsure to use Hollard's insurance license to provide products in different countries where Hollard has a presence. MicroEnsure can write specific classes of business on Hollard's books without having to solicit new capacity or to put up risk capital itself. Hollard benefits from increased insurance volume, while MicroEnsure enjoys a 50 per cent profit share of the underwriting gains. For the MFI, the use of a captive can be the first step towards building up the know-how and capital to start its own insurance company.

4 > IMPROVING BUSINESS PROCESSES

The provision of microinsurance often involves several parties working together on the various tasks needed to administer and service an insurance policy. The division of these responsibilities should be done in such a way as to minimise costs and maximise client value. In the partner-agent model, the roles might be divided as depicted in table 8, although as the relationship matures, the MFI may take on additional responsibilities, particularly if it has higher aspirations for its insurance programme. If a broker is involved, it might assume many of the shared responsibilities and perhaps some of the MFI's role as well, allowing the MFI to focus on its core business of savings and credit. If the MFI is self-insuring, then it assumes the entire range of responsibilities. The division of labour needs to be agreed upon and pilot tested before the launch to make sure that the expectations of all partners are aligned.

Table 8: Distribution of roles and responsibilities in the partner-agent model

MFI's role	Shared responsibilities	Insurer's role
Initial screening of clients	Product design	Risk analysis
Market research and feedback	Product testing	Statutory obligations
Consumer education	Pricing	Legal issues
Sales	Business process analysis	Capital mobilization
Assisting clients with applications	Staff training on insurance	Reinsurance
Premium collection	Processing applications	Asset and liability management
Assisting clients with claims applications	Contract preparation	Reserving
Agent incentives	Conflict resolution	Investments
	Claims review and assessment	
	Claims payments	
	Internal audit	
	Data management and analysis	
	Performance monitoring	

Source: Adapted from Churchill et al., 2003.

The critical factor in determining the level of engagement, and which responsibilities the MFI will undertake, is the MFI's capacity. Do staff have the skills to sell policies and process claims? Is the organization structured to accommodate insurance processes on top of its savings and credit functions? If the MFI does not have the in-house expertise, where can it get it?

This section discusses some of these roles, or business processes, to explore how MFIs can improve client value. It begins with product development, where it is important for MFIs to participate, whether through market research or business process analysis, to ensure that insurance will meet its needs and the needs of its clients. Subsequent sub-sections deal with consumer education, sales practices and the structure and incentives for frontline staff. These are critical issues, particularly in light of the product evolution towards greater voluntary cover.

The section then tackles claims processing, arguably the most critical aspect of microinsurance operations, and the one that tends to get the least attention. When new products are designed, the focus is often on the upfront activities, especially design and marketing, with insufficient concern for ensuring that policyholders who experience the event insured against are compensated quickly and efficiently, while fraud and claim rejections are minimized.

The final sub-section considers monitoring mechanisms used by MFIs to track and improve their performance.

4.1 PRODUCT DESIGN AND PILOT TESTING

Without question, the starting point for designing products is the needs and preferences of the target market.⁴ Few would argue with that statement, and yet over and over again MFIs and insurers overlook the obvious and design products that suit themselves instead of cover that is pertinent for the market. MFIs that self-insure have perhaps more flexibility to offer relevant risk management solutions, but they might not have the capacity to be too innovative. Insurers might have the expertise, but often prefer taking the easy way out by trying to simplify existing products instead of developing new products from scratch.

If MFIs are using the partner-agent model, then they need to recognize that their job is to represent their clients' interests. They need to know what their clients want, and then negotiate with the insurer so that the product and process will be appropriate for their current and prospective clients. From the experience to date, it appears that many MFIs are more focused on meeting their own needs, such as negotiating generous commissions.

It is good practice to use pilot phases to test new products and processes on a small scale before the full product launch. Pilots that are organized as distinct activities, with a pilot protocol and an evaluation plan, are likely to produce the most useful results. In situations where MFIs skipped the pilot phase, they often encountered challenges that were difficult to correct because they occurred on a large scale. For example, Faulu, an MFI in Kenya, had to terminate a product after it realized that the insurance company's systems were not ready to handle large volumes of correspondence and data, resulting in customer dissatisfaction. This could have been mitigated if the scheme had begun with a controlled pilot. Instead, Faulu needed to invest heavily in damage control.

MFW successfully used its pilot to validate and improve the design, administrative processes and promotional materials for its hospital cash product. Before commencing, MFW designed a protocol for the pilot adapted from Steinman (2011) that defined how the pilot would be conducted, the processes to be tracked, and the performance indicators to be measured. In particular, the protocol outlined:

- key features of the pilot, such as duration, scope, and expected activities
- roles and responsibilities of the pilot test team
- reporting requirements
- key performance indicators (KPIs) and desired targets for the KPIs
- success/failure conditions, i.e. conditions or results based on which the pilot would be placed on hold or permanently halted.

The pilot was kept small and was staged to create focus and minimize cost and disruptions. MFW selected two of its 24 branches for the pilot, beginning with its largest branch located near the head office in Amman. The MFI tracked progress and collected quantitative and qualitative feedback from clients and staff using focus group discussions and surveys, and through observation of pilot activities. MFW conducted a formal review at the end of the pilot. Based on the findings, MFW improved its marketing materials, training for loan officers and claims submission processes before systematically rolling out the product to its remaining branches. For example, MFW revised the client brochure to include simpler language and adapted the sales tool to make it easier for loan officers to use it when communicating with clients. The pilot also highlighted the need to expand communication with clients after enrolment.

4.2 CLIENT EDUCATION AND SALES

Creating awareness and understanding of insurance among the low-income population is a challenge that must be met for microinsurance to be successful. As such, it is in the interests of all parties to promote financial literacy and insurance awareness, but it can be unclear whose responsibility this is or whether it can be shared.

⁴ For information on how to conduct market research, see Sebstad et al., 2006.

MFIs have tested a variety of approaches to client education. AMUCSS faced difficulties in educating clients, given the need to work in 13 different languages. One solution was to use video and audio testimonials, dubbed into local languages, which the cooperative branches could broadcast on a continual loop. To ensure the consistency of its messages, MFW developed picture-based storyboards that loan officers used to explain the product to its clients. Then supervisors followed up with a sample of clients who had heard the presentation to see if they had really understood what had been explained. It is also useful for clients to get something that they can refer to later. A simple brochure that explains the product and process visually can be effective, as illustrated by figure 6.

Figure 6 : Illustrated brochure explaining a microinsurance product

BENEFITS

BENEFIT	COVER
OUTPATIENT	Unlimited with 10 paid Kshs 200 per visit
INPATIENT FAMILY COVER	Kshs 200,000 annual limit
PRINCIPAL LIFE BENEFIT	Kshs 100,000
CRITICAL ILLNESS COVER	10% accumulation of life benefit
PERMANENT AND TOTAL DISABILITY BENEFIT	50% of life benefit
CHRONIC (LONG TERM) ILLNESS COVER	Unlimited with Kshs 20,000 per year
LAST EXPENSE	Kshs 20,000 annual limit
SOCIAL WELFARE (WELFARE)	Kshs 10,000
ADDITIONAL MEMBER	Kshs 1,000

OUTPATIENT: UNLIMITED

- GENERAL MEDICAL CONSULTATION
- PRESCRIBED LABORATORY TESTS
- PHYSICIAN'S DISCRETION PRESCRIPTIONS ON-CLINIC
- ACCIDENTAL INJURY & DEATHS - OPTICAL & DENTAL
- NO CO-PAID PAYMENTS IN DESIGNATED CLINICS
- 24 HRS

INPATIENT: LIMIT Kshs 200,000

- OUTPATIENT APPROVED ADMISSION APPROVED HOSPITALS (WELFARE SHARED WITH SURVIVAL CHARGES)
- MATERNITY & FREQUENT POST-NATAL STATE OF POLICY (WELFARE SHARED WITH SURVIVAL CHARGES)

EXCLUSIONS

- CHECKUPS
- WELFARE & ULTRASOUND EXAMINATIONS
- WELFARE & WELFARE EXAMINATIONS
- BEAUTY & COSMETIC TREATMENT OF SURGERY
- SELF-REFLECTED INJURIES, SUICIDE, ACCIDENTS
- INJURY BY HEAVY WORK, ACTURES, HORSES OR SPORTS
- FAMILY PLANNING, INFERTILITY OR HORMONE TREATMENT
- NON-APPROVED ADMISSIONS
- NON-APPROVED HOSPITALS OR CLINICS

WELFARE

- MARRIAGE BENEFIT - UP TO 10,000

LAST EXPENSES & LIFE BENEFITS

- CRITICAL ILLNESS OF DISEASE - 10% LIFE BENEFIT IN ADVANCE
- PERMANENT TOTAL DISABILITY
- LAST EXPENSE - ANY 10% DEATH WITHIN FAMILY LIFE BENEFIT PRINCIPAL OR DEATHLY INJURY

life benefits...

1. DEATH OF PRINCIPAL
2. PROVIDE DEATH CERTIFICATE
3. FILL CLAIM FORM - PAYMENT

health insurance...

1. APPROVED PROVIDER
2. IDENTIFY YOURSELF
3. TEST POLICY NUMBER
4. CO-PAY KSHS 200
5. TREATMENT

last expense...

1. NOTIFY FAULU WITHIN 24 HOURS
2. PROVIDE EVIDENCE
3. FILL CLAIM FORM - PAYMENT

Fauluafya
YOUR HEALTH. YOUR SUCCESS

info pack

12 MONTHS

Sign up...

- COMPLETE FORM
- SHOW MATERIALS TO 2ND
- LIST APPROVED PROVIDERS

1 MONTH WAITING PERIOD BEFORE ACTIVE

FOR ANY ENQUIRIES CONTACT CUSTOMER SERVICE ON 0728 446 800, 0736 170 451 or 020 2388888
www.faulukenya.co.ke

In researching and analysing the needs of the low-income insurance market in Bolivia, Prodem FFP realized that its clients often had a negative perception of insurance and insurance companies. To them, insurance meant a lot of paperwork, complicated products that were hard to understand, and companies that were slow or unwilling to pay claims. Prodem concluded that it was necessary to change this perception if it wanted to produce a successful and sustainable microinsurance product.

Along with its insurance partner, the MFI designed two voluntary products, and focused on making them accessible, through simple enrolment and fast claims settlement, and comprehensible, with few exclusions – the life product even covers suicide. The products were labelled “Prodem Vida” and “Prodem Bienes” to take advantage of the trusted brand of the MFI. The life product requires clients to complete a simple one-page form during enrolment that includes two questions, “Are you healthy?” and “Do you have a congenital disease?” For the property product, it redesigned the claims process so that claims could be settled in three to four days, while for traditional products it can take three to four months. The MFI has sold 150,000 life policies (49,000 are currently active) and over 2,000 property policies since 2009. Prodem FFP

believes that its success is attributable to word-of-mouth marketing resulting from fast claims settlements.

A common complaint by loan officers who are responsible for selling insurance is that it takes too long to explain the product and its benefits. In fact, the problem may be that the product is too complicated to begin with. For MFIs with streamlined processes, it is also hard for them to integrate the consumer education activities into their operations. In this case, it may be more effective if the education is done by other people or even another organization.

2) PRIORITIZE SAVINGS

When adding voluntary components to an insurance portfolio offering, the MFI needs to consider how to sell to its target market because selling insurance requires a different skill set than selling loans. While working with its member institutions in Mexico, AMUCSS found that MFIs that already had savings products were better suited to selling insurance than credit-only schemes. To promote savings, agents needed to persuade clients to trust the institutions, and agents who already had expertise in conducting these conversations were more comfortable selling insurance. Box 11 provides additional insights about building insurance sales skills among the field staff.

Although MFIs often prioritize consumer education, perhaps they should give greater attention and emphasis to staff education. If the MFI's frontline staff members do not believe in insurance and do not see it as a valuable risk management tool for themselves, it will be difficult for them to persuade clients to purchase the cover. Consequently, management needs to find ways of turning staff into insurance zealots, who are prepared to proselytise about insurance.

9) BUILD INSURANCE CAPACITY

A key component of this conversion is for staff members to have the same insurance coverage, so they can speak about it from the heart and share their own experiences, explaining why they find the coverage and peace of mind so valuable. One African insurer refused to work with an MFI because its staff were covered by a different insurer. Since they could not speak about its product first hand, the insurer believed that loan officers would not be well positioned to promote it to their clients. In addition, staff must have tools and techniques to answer questions, effective methods to communicate to potential policyholders, and strategies to overcoming resistance by reluctant consumers.⁵

Selling does not end with the sales pitch. Staff need to be trained and monitored properly to ensure that they follow through correctly with the enrolment process, including data entry. In Indonesia, Allianz assumes that the majority of lapses in the endowment product distributed through the MFI VisionFund were due to problems with enrolment and data entry by the distribution partner, not due to the unwillingness of customers to pay the premium. Numerous applications were not entered into its MIS even though loan officers had already started collecting premiums. Providing introductory training to partners was insufficient. Instead, Allianz believed that the training should have been provided on an on-going basis and the insurer should support distributors to overcome implementation challenges over time.

On-going staff training should include refresher courses and on-the-job training. It may be cost-effective for the insurer to conduct the training as it can make sure that staff are properly versed on the concepts and can explain the product correctly to clients. MFIs should convince insurers that funding effective staff training actually allows the insurance company to reduce its own risks by making sure that the people who represent the products have the right information.

⁵ For tools and training materials for microinsurance sales forces, see Guarnaschelli et al., 2012.

Box 11: How to sell insurance.

Although studies find that the hypothetical demand for insurance is high, uptake of voluntary insurance is often slow and renewal rates are low. In the mainstream insurance market, this phenomenon is well known, resulting in the adage “insurance is sold, not bought”. When an MFI decides to offer a voluntary product, it must consider the challenges of selling an unfamiliar product to a target market that may not trust insurance or insurance providers. Some of the features that have helped MFIs to get their insurance products off the ground are:

- **Simplicity:** A simple product design with few exclusions is easier for staff to explain and for clients to understand.
- **Ease:** In Nicaragua, one MFI gave away tickets for 6 free months of insurance. All the winners had to do was go to the MFI with their documents, ID, photo and copies of children’s birth certificates to register. Yet only 27 per cent of the winners signed up; the rest said it was too inconvenient. When agents were sent around to fill out forms and take pictures so that potential clients could do everything at their shops, enrolment went up to 68 per cent (Leatherman et al., 2010).
- **Clarity:** Insurance is burdened with more jargon than other financial products, so MFIs must make a special effort to ensure that the terms and conditions are explained in a way that staff and potential clients can understand. Some MFIs do not even use the term “insurance” because of the baggage that can come with it, preferring instead to refer to health or funeral benefits.
- **Communication:** Many microinsurers have used consumer education campaigns to help communicate the concept and appropriate use of insurance. Typically these campaigns rely on pictures, games and theatre, rather than simply words, to communicate effectively (Dror et al., 2012).
- **Branding:** MFIs that have a recognized and trusted brand can take advantage of it to bolster the image of insurance. For example in Bolivia, the microinsurance products offered by the MFI Prodem FFP are named “Prodem Vida” and “Prodem Bienes”.
- **Public relations:** MFIs that want to encourage potential clients to trust them tend to spend more time building relationships that demonstrate a long-term commitment to the community that goes beyond making a profit.
- **After-sales service:** One way that microinsurance distinguishes itself from conventional insurance is by taking the emphasis off sales and putting it on service, which means making sure clients know how to make claims, assisting them in meeting their documentation requirements, and ensuring that claims are paid quickly with a bare minimum of rejections.
- **Publicity around claims:** Positive experience spread by word of mouth early on is the key to a product’s growth. One of the most common public relations activities for life insurers is to hold claims award ceremonies, where a beneficiary receives an insurance payout as a public event. Testimonials from beneficiaries can be used to communicate the importance of receiving an insurance settlement when a family needs it the most.
- **Fairness:** MFIs can promote the solidarity dimension of insurance so that people do not feel they have wasted their money if they do not make a claim. If a claim is denied, staff must demonstrate that the denial is fair. An appeals process that is well advertised, simple, friendly and free from manipulation can help facilitate this.

Source: Adapted from Frankiewicz and Churchill, 2011.

4.3 SALES FORCE STRUCTURE AND INCENTIVES

The evolution towards voluntary products raises particular challenges for MFIs regarding how to structure and reward their sales force. Assuming that its staff are legally allowed to sell insurance, does it make sense for them to do so? This partly depends on the MFI's method of delivering financial services. If it has a branch structure, then specialized insurance agents may be appropriate; but if services are delivered in the field, for example through village banks, then an integrated approach may make more sense.

Where an MFI's staff are responsible for selling, it is useful to give them non-financial compensation incentives as MFIs often do not reward staff financially for insurance sales, especially when insurance is competing with other responsibilities. Even when incentives are available, they tend to be small compared to the base salaries of the loan officers and may not sufficiently motivate sales. It can also be challenging to strike the right balance. Orchard Insurance was disappointed by the sluggish sales of its voluntary funeral product, delivered through Select Africa, so the insurer introduced an incentive for the loan officers; the MFI then complained that staff were too focused on insurance and did not pay sufficient attention to generating new loans. Box 12 describes the challenges that VisionFund and Allianz faced in Indonesia while distributing a voluntary product through loan officers.

Box 12: Challenges of insurance sales in Indonesia

In Indonesia, VisionFund serves as a distribution channel for Allianz's voluntary life insurance product, Tamadera. But with only 360 policies sold in the first 18 months after the November 2010 product launch, Tamadera has not been successful. The MFI's challenges in promoting the product reflect common difficulties experienced by MFIs:

- 1) Lack of ownership and focus:** Processes and targets at VisionFund remain focused on credit operations, especially as VisionFund struggled with a decrease in loan portfolio quality at the time of the product launch. Despite management appeals, in the day-to-day field activities there is little focus on insurance.
- 2) Low incentives:** The incentive scheme for Tamadera is not attractive enough. At maximum incentive levels, if 80 per cent of a loan officer's customers buy insurance, loan officers can increase their monthly salary by 20 per cent. Moreover, performance targets for insurance play no role in staff evaluation and promotion. Loan officers and administration staff therefore perceive insurance as an additional burden to their daily job without seeing any benefits for themselves.
- 3) Low self-confidence of field staff:** Loan officers do not feel sufficiently confident to discuss insurance matters with their customers. Selling microloans, which are in high demand, is much easier and faster than persuading customers to join Tamadera, where demand needs to be stimulated through repeated explanations.
- 4) Timing and resources:** Loan officers are unsure when to best explain the product and when to push for enrolment. Also small hindrances can have a big impact. Even if customers are willing to enrol, loan officers often do not have enrolment forms with them. Moreover, loan officers report that their microcredit workload is already high, which leaves little time for insurance activities.

Source: Allianz Life Indonesia Learning Journey (ILO's Microinsurance Innovation Facility, 2012) at <http://www.microinsurancefacility.org/en/learning-journey/tamadera-%E2%80%93-savings-and-protection-prosperous-future-0>.

A review of sales force development practices by Guarnaschelli et al. (2012) highlights the benefits of using a mixture of financial and non-financial incentives to promote insurance sales. Generous financial incentives linked to sales volumes can encourage mis-selling, that is forcing a sale without the full consent of the client or without their having a clear understanding of the product's terms and conditions. To avoid mis-selling, incentives should be given for both the quantity and the quality of sales.

Perhaps the most important sales incentive for an MFI's staff is to see the strong link between insurance and their core business. If remuneration is tied to loan repayment, and if insurance enables better repayment by protecting clients against relevant risks, then staff can see clearly how they benefit from insurance. Some MFIs, like Fundación Mundial de la Mujer Bucaramanga in Colombia, emphasize to loan officers the other benefits that could accrue because of insurance, including fewer loan payment lapses with clients who have insurance; more stable clients who are more likely to borrow more money; and happier clients who are more likely to be retained in a competitive market (McCord, 2011). Similarly, if tellers are rewarded for new accounts and larger account balances, and insurance increases account balances as described in box 3, then they will be more motivated to sell insurance.

KGFS' unique perspective seeks to align staff incentives with the goals of the wealth management approach. If it linked incentives to product sales, such as loans disbursed, policies sold or savings balances generated, the MFI believes it would encourage staff to push products with high commissions, creating consumer protection concerns. Instead, the KGFS model aims for a shift from a supply-driven, one-size-fits-all focus to a customized sales process centred on client needs. Performance appraisals for wealth managers emphasize completing the household analysis and delivering advice correctly. KGFS also evaluates staff on process goals, such as enrolment rates, the accuracy of data on clients' financial well-being, and staff understanding of households and products. The long-term vision is to link staff financial incentives to improvements in household financial well-being.

4.4 CLAIMS PROCESSING

Claims processing is perhaps the most important aspect of microinsurance operations because it provides the best opportunity to demonstrate the value of insurance. Insurance hinges on the trust between policyholders and insurers. If managed badly, the claims process can undermine the client's trust in the insurer and MFI; or conversely, when dealt with well, it can significantly improve the value of insurance to the client. Whether it is the risk carrier or the interface between the customer and the insurer, it is important that the MFI advocates and contributes to a process that administers claims efficiently, prudently and in a way that gives clients maximum value for money.

Claims processes need to balance scrutiny with flexibility. An insurer has certain minimum standards to which it will adhere when processing claims, in order to protect against fraud, while still paying legitimate claims promptly. Slow or unfair claims processing can affect MFIs' reputations negatively, as they are the face of the insurance products to clients. For its life insurance product, CARD MBA takes the speed of claims payment so seriously that it promises to pay benefits within 24 hours if staff can see and identify the body; otherwise it pays within 3 days of receiving all of the documentation for standard claims, and within 5 days for complicated claims.

SAJIDA Foundation in Bangladesh decentralized its claims process to improve efficiency. The risk of a decentralized approach is that local staff can collude with clients and process claims that are not valid. To implement this process for health insurance, SAJIDA developed a checklist for field staff to use when processing claims, and then formalized the checklist through an automated form in Microsoft Access. The tool enables branch managers to answer a series of questions. At the end, the tool advises if the claim is approved or rejected, or if it should be referred to the head office. The responses are automatically saved in a record that the user cannot edit. Using these saved responses and claims documents, SAJIDA hopes to expedite claims payments without exposing itself to fraud.

There is a greater danger of fraud when claims adjusters have some discretion, as in the case of Fonkoze. Fonkoze has tried to standardize its claims process by employing facilitators at the central level who travel to branches that have submitted claims. The role of the facilitator is extremely important to prevent the conflict of interest that would exist if the branch staff were solely responsible for carrying out these activities. Branch staff have a close relationship with their clients and a clear incentive to accept claims to improve the performance of their loan portfolio. As the facilitator is detached from the branch, he or she can conduct an objective assessment of the losses incurred. Fonkoze also modified its claims process to make adjudication more objective. The claims assessment form completed initially was composed of open questions that often invited vague answers that were insufficient for the microinsurance team to make a payment decision. Based on this experience, a new format was developed that contained objective yes/no questions and that was easier to complete and assess.

MFIs usually play an active role in claims processing as this is the stage where clients see the most value from products. Typical involvement includes assisting clients to complete forms and collect necessary documents. With their reputation at risk, some MFIs have gone further and taken on more responsibility by negotiating with their insurers to give them authority to verify and pay claims. Insurers may be reluctant to relinquish this function given the MFI's lack of insurance expertise, so the MFI may have to earn the right to take an active role in claims management by demonstrating its competence. The following examples illustrate how MFIs can improve claims processes and make them client-centred.

Claims advances: Some MFIs advance a portion of the funds to clients while claims are being processed, to help with immediate needs, which reduces the need for clients to borrow. For example, Prodem FFP advances a quarter of the benefit for life insurance (US\$ 365) within 24 hours after a claim is submitted, to cover burial costs. The insurer pays the balance (US\$ 1,100) within 15 days of the death certificate being submitted. In other countries, regulations may prevent MFIs from paying claims to clients. For instance, in the Philippines rural banks are unable to advance claims, as they cannot assume any insurance risk. MFIs can overcome this challenge by converting the advance into a loan if the insurer rejects the claim. For example, KGFS' personal accident coverage, with benefits between US\$ 2,000 and US\$ 6,000, usually takes 15 to 30 days to be settled. KGFS immediately provides a loan of US\$ 100 to the client to meet urgent expenses and clients repay the loan once they receive the claim payment. Since inception in January 2009, KGFS has processed 80 claims with no rejections, with a claims ratio (claims paid/premiums collected) of 77 per cent.

Pre-authorization for the MFI to pay certain claims: To finance claims, some MFIs and insurers have set up a float whereby the insurer provides an advance to the MFI from which to pay claims. At the end of each reporting period, the actual claims are compared to the float, with a net transfer made to reconcile the accounts. Using a float is an approach that not only eliminates claims delays, but also reduces the transaction costs for the insurance company, which only needs to make one bulk payment per month. If commissions or other financial transfers are made between the partners, these can also be netted off with premium or claims payments to save on transaction costs.

Another approach is for the MFI to pay claims from the premiums collected but not yet paid to the insurer. The MFI verifies that the claim is valid and, if so, pays it. At the end of the month, the MFI submits the net premium schedule showing the total premiums collected and the total claims paid, along with all claims documentation. In the event that the insurer identifies a claim that was paid in error, the MFI is responsible for refunding the insurance company. In the partnership between Madison Insurance and its MFI partners in Zambia, MFIs are allowed to settle funeral claims directly and offset the amount from premiums collected. Madison Insurance is comfortable with this approach because of the underwriting training and experience gained by its MFI partners (Manje, 2005).

Another option is to authorize the MFI to pay some claims without requiring approval from the insurer. This compromise arrangement allows the MFI to complete the claims process for smaller claims, while the insurer has to approve larger claims. For example, with MFW's hospital cash product, the MFI can pay claims for hospital stays of up to 6 nights; if clients are in hospital for

more than 6 nights, the claim goes to the insurer. The claims process requires a discharge summary and a claim form to be filled in by clients and submitted to the branch, which forwards them to the head office. MFW issues the cheque and each month it reconciles the payments by deducting claims paid from premiums collected. To manage this additional responsibility, and make sure that it does not approve fraudulent claims, MFW hired a specialist who previously worked as a claims assessor to oversee the process.

Processing claims in-house: Some larger MFIs have set up in-house claims processing centres. BASIX, for instance, has a dedicated team responsible for claims processing that acts like a third-party administrator (TPA). The MFI's objective was to standardize the processes and have greater control over quality. BASIX felt that its clients needed support to submit claims and as the insurer was not able to work directly with the clients, it felt that it was in the best position to do so.

For self-insured schemes, one advantage of carrying the insurance risk is that the MFI has control over claims processing. This can allow for unobstructed innovations in developing a procedure that satisfies clients and disburses benefits efficiently. For example, SAJIDA carries the risk for its life, health and disaster insurance policies and has complete control over the claims processes. SAJIDA employs its own doctor to ensure speedy decisions on health claims. Assigning the claims settlement process to a doctor also has the advantage of picking up fraudulent claims involving fake prescriptions made for illnesses that do not correspond to them. For life insurance, a death certificate is usually required; but if it is not available, other means of verification are allowed. SAJIDA feels that fraud for life claims is difficult in the close-knit communities that it serves.

Guarantee fund: When using the partner-agent model, MFIs are particularly concerned about putting their reputation at risk, so they want to minimize claims rejection. Insurers might not have quite the same concern, and they may be more willing to reject claims that they think are suspicious. To manage this difference in perspectives, some MFIs have created a guarantee fund from which to pay claims that the insurer rejects if the MFI believes they are valid.

Service standard agreements: When MFIs partner with insurers or TPAs for claims processing, it is important to have an agreement on service standards to enforce timeliness. The service standard agreements should outline the maximum number of days within which claims should be settled; for example, the insurer could agree to pay all claims within 10 days of receiving proper documentation, or else pay a penalty.

Negotiating document requirements: Claims processes need to align with the circumstances of the low-income market. BASIX found that clients had difficulty producing the documentation required for its health insurance product because hospitals were not willing to provide the paperwork as they did not want to report all earnings in order to avoid paying taxes. Clients with genuine claims could not produce the necessary evidence of hospitalization and expenses. BASIX and its insurer modified the requirement and allowed the use of a declaration from the treating doctor as proof of hospitalization. This freed the client from having to collect admission and discharge summaries from hospitals. Such a change was risky for the insurer as it left room for fraud, so the MFI's staff serve as an additional verification.

MicroEnsure and TSKI found that the latter's insurer's documentation requirements were burdensome for life insurance beneficiaries, which meant that the claims payment process averaged 115 days. According to MicroEnsure's CEO, Richard Leftley, "It cost one client 14 per cent of the value of her claim (in lost time and fees) just to get the documentation she needed to make the claim." To simplify processes, TSKI was made a trustee on the policy. The documentation requirements were reduced; for example, certificates or affidavits from village heads were accepted in place of death certificates. Instead of excluding pre-existing conditions, the MFI introduced a graduated benefit table to increase the benefits over time, which streamlined the approval process, decreasing the claims settlement time from 3 months to 10 days (Matul et al., 2012; MILK, 2011).

4.5 PERFORMANCE MONITORING

Microfinance institutions that self-insure should monitor the performance of their insurance activities as an insurance company would, with a separate balance sheet and income statement, consideration for cost allocation, the maintenance of reserves, and a clear policy on investments that separates credit and insurance risk. These organizations should carefully monitor the ten key performance indicators recommended by the Microinsurance Network (see Wipf and Garand, 2010).

1. **Incurred expense ratio** = Incurred expenses / Earned premium
2. **Incurred claims ratio** = Incurred claims / Earned premium
3. **Net income ratio** = Net income / Earned premium
4. **Renewal ratio** = Number of renewals / Number of potential renewals
5. **Coverage ratio** = Number of active insured / Target population
6. **Growth ratio** = (Number of insured current period – Number of insured previous period) / Number of insured previous period
7. **Promptness of claims settlements**: Analytical breakdown of service times taken to report and process a set of claims
8. **Claims rejection ratio** = Number of claims rejected / Number of claims in the sample
9. **Solvency ratio** = Admitted assets / Liabilities
10. **Liquidity ratio** = Available cash or cash equivalents / Short-term payables

The Network encourages microinsurers to set up internal targets for these indicators and to carefully monitor both viability and client value. There is also an Excel-based factsheet, an easy-to-use tool that comprises financial statements adapted for microinsurance practitioners and calculates the performance indicators (see www.microfact.org).

Even MFIs that partner with insurers, either directly or via brokers, should monitor the performance of their microinsurance products, including most of the ratios above, although it will depend on whether the products are mandatory or voluntary, as summarized in table 9. In addition to these standard indicators, MFIs need to have an adapted version of the **expense ratio** that compares the income that they are generating from insurance activities to the corresponding operating expenses. Often MFIs that provide mandatory insurance do not believe that they have any expenses, but a closer look at how people allocate their time reveals that this is a severe under-estimation. A clearer estimation of an MFI's operating expenses on insurance may indicate a need to streamline systems and processes, and also could create a justification to renegotiate the commission income that it receives from the insurer.

Table 9: Performance indicators for MFIs to track

Mandatory	Voluntary
2. Incurred claims ratio	2. Incurred claims ratio
3. Net income ratio	3. Net income ratio
	4. Renewal ratio
	5. Coverage ratio
	6. Growth ratio
7. Promptness of claims settlements	7. Promptness of claims settlements
8. Claims rejection ratio	8. Claims rejection ratio

Besides tracking costs, there are a number of reasons why MFIs should carefully monitor insurance performance indicators:

1. **To monitor client value**: Matul et al. (2012) demonstrate that there are many dimensions to client value, and small changes can make a significant difference in how clients perceive insurance. To identify what changes to make, MFIs have to know whether claims are being paid quickly and not being rejected, and what percentage of the premiums are returning to

policyholders via claims. Regarding claims rejections, it is important to note that these can occur at different stages in the process – by the frontline staff, at the branch, at the head office and by the insurer. By tracking rejections at each level, the MFI may identify the need to enhance consumer education, staff training and/or claims processing.

2. **To assess product profitability:** Microinsurance helps to diversify an MFI's income stream through commissions, fees or profit sharing. A diverse product portfolio provides cross-selling opportunities and spreads the cost of acquiring clients across multiple products, enhancing product profitability – or at least one assumes that microinsurance can make these positive contributions. To verify that it is indeed the case, there is a need to monitor relevant income and expenses.
3. **To assess client retention:** Insurance may help MFIs to retain existing clients and to attract new clients. Through exit interviews and customer satisfaction surveys, MFIs can validate if that is the case.
4. **To establish leverage with insurers:** A detailed understanding of the performance of products provides MFIs with the ability to negotiate better terms with insurers if the product is performing well. In this case, information is indeed power.

As an example of the last point, BASIX negotiated better products from insurers because it was armed with convincing evidence. When the MFI first introduced credit life plus, a lack of data made it difficult to price and conservative assumptions were used. After one year, the mortality experience was better than expected. The premium could have been reduced by 50 per cent, but instead the product was redesigned to cover the borrower and spouse for the same premium. Similarly, when BASIX's hospital cash product had better than expected claims experience, the MFI negotiated the daily benefit to increase from INR 300 per day to INR 500 per day. BASIX also added hospitalization benefits of up to INR 25,000 (US\$ 500) in the event of accidents and compensation of up to INR 50,000 (US\$ 1,000) for permanent disability. Price changes can be difficult if they require regulatory approval. When products perform well, and clients have demonstrated an ability to pay the premium, an alternative is to enhance the benefits based on a thorough understanding of client needs and preferences.

Segmenting claims data properly can take time and effort, but it is essential to understand the drivers of claims costs properly and to develop targeted action to address them. This is important information for MFIs that want to learn more about client needs and behaviours. One technique is to analyse the data on a per unit basis instead of looking at aggregate amounts. For example, VimoSEWA analyses the health claims of various segments including rural/urban, diagnosis, age band, gender, and length of time enrolled. By looking at claim incidence, cost and diagnosis per 1,000 members per year for each segment, VimoSEWA more clearly observed trends and reduced the fluctuations in the data created by changes in membership and use of health-care services. VimoSEWA's claims analysis showed that water-borne diseases, respiratory ailments and hysterectomies were the primary drivers of claims costs, and in many cases these were preventable. To address this, VimoSEWA created health programmes to educate women on how to prevent illness and avoid unnecessary (and costly) hospital stays. The health claims analysis is a part of VimoSEWA's comprehensive monitoring and evaluation (M&E) system described in box 13.

Box 13. VimoSEWA's three-tier M&E system

VimoSEWA believes that performance management is the key to running a voluntary microinsurance programme. This insurance intermediary uses a three-tier M&E system to monitor several indicators like acquisition costs, gross and net margins, servicing costs, fixed costs, non-core revenues, product mix, and sales mix across products, channels and locations. The first tier is a basic M&E report generated on a monthly, quarterly and annual basis, which captures exhaustive information on sales, targets, margins and claims.

At the second level, a more focused annual review is done on critical parameters affecting viability. This review is done with respective department heads and team leaders. Specific action points, targets and responsibilities become part of this review so as to ensure that staff can take action based on the analysis.

Lastly, a comparative snapshot of ten critical indicators is drawn and shared with partners and the entire staff. This snapshot grades the organizational performance, which forms the basis of the performance appraisal of team members. Besides this structured M&E system, VimoSEWA also undertakes specific analysis of products in terms of claim incidence, claim size and claim ratio, which are analysed at the level of partner and frontline sales force to identify divergent trends and enable corrective action.

Source: MFI interviews.

UNACOOPEC believes that its funeral product, offered in partnership with Allianz, has a positive impact on its SACCO members because it:

- enhances client retention in an increasingly competitive market where traditional banks are going downmarket
- increases enrolment and enhances the social capital of the SACCOs with each new member
- increases profits because of the microinsurance product sales and the new member fees.

In the 30 branches with high insurance sales, UNACOOPEC has seen an increase in deposits, an increase in demand for credit, and 10 per cent of inactive accounts becoming active, which it considers the most important indicator. These SACCOs have been able to use the revenue from the microinsurance to pay their administrative fees to UNACOOPEC, helping the microinsurance team make the case to other SACCOs that insurance could be an important source of revenue.

Besides monitoring financial performance, some MFIs are also keen to assess the social contributions of insurance.⁶ Fonkoze systematically monitors the effects of its products and services on its clients using field officers called Social Impact Monitors (SIMs). The SIMs use a poverty scorecard and food security survey to collect verifiable data on different aspects of clients' social development including housing, food security, assets, literacy, sources of income, school attendance and business expenditure. Besides using these two tools, the SIMs conduct in-depth interviews and focus group discussions across the country. Fonkoze uses the data to understand the economic and social conditions of its clients – especially how these change over time – and to refine and improve products and services, or create new ones, to better suit their needs. Through these efforts, Fonkoze and its insurance partner now have much better data on client mortality and morbidity, and health-care needs, in order to design suitable products. Fonkoze is also trying to collect data to assess how clients would have fared without access to insurance.

⁶ The Microinsurance Network has developed a set of social performance indicators for microinsurance that could apply to insurers and MFIs. Information is available at <http://www.microfact.org/social-performance>

> CONCLUSION

The paper highlights how MFIs can improve their insurance offering. Based on the experiences of leading organizations, the paper describes pathways of product evolution that can result in products that provide better value for clients while enhancing the benefits for the MFI. The paper also explores a range of institutional options, and describes how operational processes can be enhanced. Throughout the paper the **ten key recommendations** summarized in the Executive Summary are repeatedly flagged in the margins.

But important questions remain – why are 30 per cent of MFIs not offering insurance, and why have many MFIs not evolved past basic credit life cover? Additional research is required to understand what inhibits them from providing insurance and improving products, and how those inhibitions might be overcome. MFIs might benefit from support to build their capacity to design and deliver insurance more effectively.

It is true that offering insurance can add certain risks for MFIs, especially if they are carrying the insurance risk themselves. Even if they are partnering with an insurance company, they are still exposed to reputational risks. There are also numerous operational challenges, including how to structure the roles and responsibilities of field staff, how to transition beyond mandatory cover, and how to provide incentives for sales. Perhaps the biggest challenge is to manage a streamlined claims process so the poor can easily appreciate the real benefits of insurance. If they are effective, MFIs can lay the foundation for an insurance culture in low-income communities that will enable the poor to manage risks more efficiently and thereby make a valuable contribution to breaking the vicious cycle of poverty.

For MFIs, microinsurance products are like a buffet, with lots of dishes to choose from. MFIs do not have to eat everything, but it is a good idea to begin with the starters (credit life plus). Some MFIs might stop there. Others will make sure that the starter is well digested before moving on to the main dishes, perhaps savings-linked cover, riders for credit-linked insurance or the advancement of a holistic risk management approach for clients. The dessert is voluntary insurance for the general public, and MFIs that want to watch their weight might steer clear of it.

MFIs need to think about which institutional option works best given their strategic goals. If they really want to take insurance seriously, and the market and regulatory conditions allow, then movement towards creating an insurance company could certainly be considered. While that option is only likely to be achieved under exceptional circumstances, there are numerous intermediate steps along the way that would also be viable strategic objectives in their own right, such as creating an effective insurance department or spinning it off into a brokerage. These options need to be considered carefully and MFIs need to make sure that the necessary steps are taken to build capacity and mitigate any possible risks to themselves and their clients. The key is to not rush into it!

Insurance has the potential to improve the health and welfare of low-income households, and consequently enhance the social and financial performance of the MFI, especially when considered as a component of broader risk management framework. So the hope is that MFIs will think critically about the options described here and consider their insurance opportunities carefully.

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ANNEX

PILOT PROTOCOL USED BY MICROFUND FOR WOMEN

KEY FEATURES OF TEST

Start	11 April 2010
Expected duration	6 months from second branch launch (30 September 2010)
Branch locations / starting date	Ruseifeh / April 2010 Irbid / May 2010
Expected number of insured & claims at 31 October 2010	Expected insured: 3,879 Expected claims: 252
Regular meetings of pilot test team	<ul style="list-style-type: none"> • In the first 2 months team will meet weekly, with a formal meeting once a month. • From Month 3 onwards, team will meet in the first week of the month to assess progress during the previous month, and discuss potential actions / adjustments if necessary. • Meet with insurer monthly to formally review progress and discuss any issues. • Each monthly meeting (MFW internal, and with insurer) will be minuted with action items (action, responsible party, timeline) clearly noted. Reporting to be stored and compiled and shared with other parties (e.g. Women's World Banking, ILO) as required.
Presentations to General Manager and /or Board	Meet General Manager monthly and update Board at each quarterly Board meeting.
Pilot test concludes when:	<ul style="list-style-type: none"> • pause / exit indicator is tripped. • pilot test objectives are at least 80% satisfied and insurer and MFW agree on success.
Concluding activities	<ul style="list-style-type: none"> • Develop recommendation letter to management and Board reflecting achievement of objectives and recommendations (stop, continue pilot, roll-out, other). • Compile documentation from pilot to provide to operations department. • Revise training, marketing, systems, and documentation as appropriate. • Develop plan for roll-out.

PILOT TEST TEAM

Members represent each key aspect of product implementation. Leader is a product champion, a decision-maker who can report to senior management, and will focus on this pilot test process.

Members will:

- provide assistance when appropriate
- attend regular meetings once each week / monthly
- report information on the product back to their areas
- be available to address issues during pilot launches.

Pilot test team members include:

- Pilot Lead: Deputy General Manager
- Project Manager: ILO Fellow
- Accounting: Chief Financial Officer (CFO)
- Operations & MIS: Senior Admin manager
- Network Manager
- Marketing & Training: Marketing Manager
- Microinsurance Officer.

PERIODIC REPORTING

Report	Details	Responsible	Frequency
Initial client comments	Feedback on whether the client agrees to this. Does it make sense? Does it seem helpful to them? Any confusion with the brochure?	Branch Manager of pilot branches	Weekly in first 2 months
Performance indicators	Claims ratio Admin cost ratio Claims frequency & duration Hospital stay length Rejection ratio	MI Officer & Project Manager	Monthly
Detailed claims analysis	Detailed analysis	Project Manager	Monthly for first quarter, then quarterly thereafter
Results of objectives	Results for the objectives	Project Manager	Monthly
Process quality tracking	Assessing accuracy and timeliness of documentation (applications, claim forms) submitted by branch to MFW, and MFW to insurer	CFO & Project Manager	Monthly
Marketing effectiveness report	Feedback from loan officer on marketing tools. Customer knowledge survey with clients (timing tbc)	Marketing Manager	Monthly for first quarter, then quarterly thereafter

Report	Details	Responsible	Frequency
Training assessment report (new and continuing training)	Observations & test (tbc) on loan officer understanding of Ri'aya and tools. Notes on training conducted in the preceding month	Marketing Manager/ MI Officer	Monthly for first quarter, then quarterly thereafter
Lessons capture report	Collation of lessons relating to preceding reports; 1. Creation of the reports 2. Key observations 3. Actions taken	Pilot Lead & Project Manager	Quarterly

PILOT END OF TEST OBJECTIVES

Objective	Objective target	Type of objective	Explanation
Minimal loss of borrowers because of policy	<2.5%	Product	Control over loss of clients due to policy. Needs to be measured through the existing exit interview structures
Claims rejection	<5%	Product	Total amount of rejections by MFW and insurer
Claim duration (event to settlement)	<15 days	Process	Up to 10 days from event to claim, up to 5 days from claim to settlement. Tracked through claim monitoring tool
Claims ratio	50–65%	Product	Total claims costs not unduly low or high (pricing expects 60%)
Systems efficiency	Fully automated for premiums and information	Process	Premium and client info are conveyed to the insurer electronically by the third month
Effective marketing	Marketing tool implemented	People	Tool to assess marketing effectiveness developed, tested, and implemented by the end of the pilot test
Effective training	Training assessment tool implemented	People	Tool to assess training effectiveness developed, tested, and implemented by the end of the pilot test. This should result in a final version of the training programme to be used for roll-out
Expenses controlled within fee earned	>100% of direct costs covered	Finance	Total direct costs by month are less than the amount paid to MFW in fees

PAUSE / EXIT IF

Non-renewal of loans	If after the second month, more than 10% of potential loan renewers in a month choose not to renew because of the insurance premium / product
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Claims rejection	If any clearly legitimate claims are rejected and total rejection ratio is >10%
Claims duration	If the average time to pay a claim exceeds 25 days in any 2 consecutive months
Claims costs	If cumulative claims costs are 50% higher than expected (after the second month). This will pose a serious risk to the project

MICROINSURANCE INNOVATION FACILITY

Housed at the International Labour Organization's Social Finance Programme, the Microinsurance Innovation Facility seeks to increase the availability of quality insurance for the developing world's low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation.

See more at: www.ilo.org/microinsurance

