WINTER 2010

In light of the Copenhagen summit and the amount of coverage climate change is getting in the media, the Microinsurance Network thought it important to address this issue and present some of the material already written about the effects of climate change and microinsurance.

Microinsurance, as a tool for risk management for the poor, is a concept firmly anchored in the financial inclusion debate, and it should certainly stay this way. The impact of global warming will no doubt have a significant effect on microinsurance providers and clients, and the need to protect themselves against its perils is ever growing.

INSURANCE, CLIMATE CHANGE AND MFIs

The following article is based on the report "Climate Change and Microfinance", published by Grameen Foundation and Oxfam America in November 2009. It discusses the potential impact of climate change on microfinance institutions (MFIs) and how they will need to adapt to the changing environment. The report examines all aspects of an MFI's activities, but this article will focus on index-based insurance and the need of "climate change proofing".

INTRODUCTION

Global warming is projected to lower the level and growth of GDP and thus increase poverty, undermining progress towards achievement of the Millennium Development Goals. Within the populations that will be most affected by global warming, the plight of many individuals is linked to the ability of MFIs to adapt to the consequences of climate change. Global warning will create covariate risk on a scale never seen before and MFIs will need to reconfigure their insurance products to deal with its consequences.

Lack of familiarity with potential products and slow adoption of known ones has limited the use of insurance by MFIs. Insurance for themselves and their clients can protect both groups from the worst financial consequences of flood, drought and disease. Insurance could become one of the most important tools in MFIs' climate change arsenals. At the same time, the increased burdens of disease and death caused by global warming will strain the insurance funds of MFIs. This double edged sword needs to be manageed appropriately.

INDEX-BASED INSURANCE

In the future, MFIs will have to develop new insurance products specifically to deal with climate change. Several organisations are field-testing new types of insurance products known as index-based risk transfer products (IBRTP), which were developed with the aid of the World Bank and donor agencies, such as the Department for International Development (DFID). These products can be important tools for adaptation. According to Barnett et al., "IBRTPs are financial instruments that make payments based on realisations of an underlying index relative to a pre-specified threshold. The underlying index is a transparent and objectively measured random variable. Examples include area average crop yields, area average crop revenues, cumulative rainfall, cumulative temperature, flood levels, sustained wind speeds, and Richter-scale measures." Area livestock mortality and satellite imagery can also be used as indices.

Several MFIs are currently participating in schemes to sell IBRTPs. The most notable example is BASIX in India. BASIX introduced the product after facing a high default rate and financial pressure in its operation in drought-prone districts in the Indian State of Andhra Pradesh. Instead of shutting down operation in these areas, BASIX joined hands with ICICI Lombard, a subsidiary of ICIC Bank, and the Commodity Risk Management Group of the World Bank to develop a weather-based insurance product for small and medium farmers in Andhra Pradesh. Since crop yields depended on rainfall, and default in loan payments was correlated with yields, rainfall was used as an index for the insurance. When the rainfall dropped below a certain level, usually 75 to 80 percent of normal rainfall, farmers received a payout proportional to the amount of rainfall up to a predetermined sum. The amount insured was based on farmers' costs of input, and the premiums were roughly 10 percent of the amount insured. The amount insured and the trigger level for payout varied by types of crop.

LIMITATIONS AND CHALLENGES

By considering both climate change and insurance modelling together, researchers at the World Bank examined the potential impact of climate change on the viability of a Malawi rainfall-index insurance programme. The authors found that climate change will increase the risk of insolvency of the insurance programme meunless the premiums and payouts are reduced, and the insurance company holds more back-up capital. Given that the premium, at 6 to 10 percent of the insured amount, is already high, insurance companies will need external help to remain solvent.

Alternatively, donor agencies could provide back-up capital, or subsidise insurance premiums to keep them affordable in the face of increased risk created by climate change. For example, OXFAM UK paid 50 percent of the premium for the first year to help launch a disaster insurance programme for coastal areas in Andhra Pradesh.

Index-based insurance that reduces risk has other limitations. Significantly, it provides no incentive for farmers to switch from risky to more sustainable products. For example, BASIX rainfall insurance could allow insured farmers to continue to produce a water-intensive crop, such as rice instead of a crop that uses less water. To counter this potential effect, MFIs could nudge their members towards sustainable farming practices by providing insurance for crops that are less susceptible to weather conditions like rainfall. Index-based insurance also suffers from the problem of basis risk; the predetermined payout may not cover the full damage.

Weather-based indices could be used to trigger funding to MFIs to deal with climate-related disasters when the value of the indices falls below the threshold level. For example, a consortium of donors could take out a contract to insure the portfolios of MFIs in Bangladesh against the risk of floods. Water levels at various flood stations in the country can be used to develop the index. When the index falls below the threshold level, the consortium will receive the payout, which it can then use to provide disaster funds for the MFIs.

CONSEQUENCES OF NOT ADAPTING

The Grameen Bank in Bangladesh has been dealing with floods since 1987 but, its biggest blow occurred in 1998 in the aftermath of an unprecedented flood that inundated two-thirds of Bangladesh for 13 weeks from June to September. Out of 2.3 million members at the time, about 1.2 million were affected by the flood. The bank faced large-scale repayment problems in several areas of its operation. At the height of the crisis, 25 percent of its borrowers were in default. The suspension of repayment and drawing down of compulsory savings drained the bank's liquidity.

The bank was able to recover only because of the special status that enabled it to borrow from the government and from commercial banks. In the end, the bank repaid the amount borrowed from the central and commercial banks on time and completely restructured its financial service delivery model into what it now calls Grameen II.

CONCLUSION

It must be emphasised that apart from reconfiguring or developing new insurance products, MFIs should take direct steps to deal with disasters by formulating a detailed disaster plan. But even this, as the example above illustrates, may not be enough to protect MFIs against the consequences of climate change. Ideally, an MFI should be able to insure its portfolio against natural disasters.

A consortium between MFIs, governments and donor agencies would be able to develop insurance products with a layering of risk coverage that would be activated depending on the extent of a loss as measured by an index. In the first layer, MFIs would use their own resources to deal with disaster if the extent of the damage were below a threshold level. In the second layer, the government would provide cover for damages above the designated threshold level. The third layer would be coverage provided by multilateral organisations in the case of a catastrophic event. Spreading the risk is imperative.

Source:
Asif Dowla, 2009: Climate Change and Microfinance
published by Grameen Foundation and Oxfam America.

CASE STUDY: THE AFAT VIMO DISASTER INSURANCE

This article is based on the paper "Insurance against Losses from Natural Disasters in developing Countries" which was published by the Department of Economic & Social Affairs (DESA) in October 2009. The paper sites a number of different microinsurance schemes designed to protect its clients against natural disasters, but we will only examine the Afat Vimo case.

PROGRAMME SET UP

Since 2004 the NGO, All India Disaster Mitigation Institute (AIDMI), has been offering a disaster insurance programme, Afat Vimo, covering households and small businesses for 19 different types of disasters, including floods, earthquakes, cyclones, fires and riots. Currently covering 6,000 clients - mostly men and women running small enterprises - it is planned to upscale the scheme to cover an additional 10,000 people in the next few years. The scheme is backed by two public insurance companies which collaborated closely with AIDMI in designing the product, setting premiums, determining cover and underwriting the risk.

On average, premiums are approximately 0.5% of the clients' annual income. They are kept affordable by relying on voluntary help from the NGO administering the Livelihood Relief Fund (LRF) and support from donors in the form of post-disaster and post-conflict interest-free loans to assure solvency. Because of the pro-poor regulatory requirements in India, the public insurers also subsidise premiums of their low-income clients from insurance in more lucrative markets.

Finally, premiums are kept affordable by limiting cover, leading some observers to claim that the main benefit of Afat Vimo has been to limit the debt that can quickly arise out of a disaster, but not necessarily to provide the poor with needed capital to fully restore their livelihoods.

CONTEXT

Until recently natural hazards have not been explicitly considered as a niche for microinsurance because they impact large regions with multiple and simultaneous losses, and thus are both more uncertain and have higher potential losses than other types of insurance. The co-variant or systemic nature of the risks – and the large capital reserves necessary to avoid insolvency - distinguishes catastrophe coverage from health, accident and other forms of microinsurance. The four basic institutional models used for providing microinsurance-type coverage for catastrophic, co-variant risks are: Community-based model, full service model, provider model and partner-agent model. The Afat Vimo all-hazard insurance programme illustrates the partner-agent model.

LESSONS

The partner-agent scheme appears to be both affordable to poor clients and, with backup capital from public insurers and donors, resilient to large catastrophes. Important features contributing to its expanding client base, according to its sponsors, are the long-standing relationship that AIDMI has with the communities it serves and the trust established through the administration of the LRF. Effectively utilising such relationships has, however, proven administratively costly. The enlisting of new clients apparently costs about the same as the premium, and the cost of processing claims about three times this amount.

Diversification and reinsurance can add significantly to the costs of providing microinsurance, which raises the challenge of assuring the financial sustainability of microinsurance providers and at the same time providing affordable premiums to poor and high-risk communities. Many support subsidies (in the broadest sense) to meet this challenge and caution against shifting full responsibility to the poor, while others warn against the negative incentives promoted by subsidies and favour limiting support.

It is notable that the Afat Vimo programme does not adjust premiums to award riskreducing behaviour, which introduces moral hazard in the sense that clients may not take cost effective preventive measures. Despite the advantages of donor-supported public private partnerships in providing sustainable and affordable insurance, there are thus concerns that excessive public and international support will distort market prices and greatly jeopardise the incentive effects of insurance.

This is one example of a microinsurance scheme designed to protect its clients against natural disasters. Afat Vimo and similar microinsurance programmes usually serve only very few clients. Scaling up across regions with uncorrelated risks adds valuable diversification to these schemes, but at the same time diminishes the institutional familiarity and trust that, contributes both to their success and reduces expense.

Source:

Joanne Linnerooth-Bayer and Reinhard Mechler, 2009: Insurance against Losses from Natural Disasters in developing Countries published by the Department of Economic & Social Affairs (DESA).

CONFERENCE REPORT: REGIONAL FORUM ON MICROINSURANCE IN CENTRAL AMERICA

In December 2009, the Central American Microfinance Network, REDCAMIF, initiated the first Regional Forum on Microinsurance in Central America: "Microseguros: Nueva meta para las microfinanzas".

Over 160 people attended the event, which was designed to allow an interchange of ideas, experiences and better practices of international experts in microinsurance. It also represented the first activity of REDCAMIF's Regional Programme to Support Microinsurance (PRAM).

Panellists discussed various experiences with voluntary products outside of credit life. These included coverage of life, funeral, labour accidents, property damages, health, and crops. According to panellists, the most complex products are most difficult to sell. The key to selling good products is ensuring that they are designed to meet the demand of customers at reasonable prices. BancoSol, a top-tier MFI in Bolivia, for example, has sold 30,000 life insurance policies and 15,000 of life plus health policies. Interactuar, a Colombian MFI, has designed innovative products that cover labour accidents and damages to micro entrepreneurs' work-related property (home, machinery, etc.). For MFIs to design these products appropriately for its clients, MFIs need to put in place appropriate client feedback mechanisms. Panellists from Zurich (International), ADOPEM (Dominican Republic), AMUCCS (Mexico) and LIMRA (Chile) described their quantitative and qualitative techniques for implementing effective market studies and ensuring that client feedback is in place as a monitoring tool for microinsurance programmes.

Panellists struggled with one of the key issues in microinsurance: commercialisation. Complex products require relatively "high touch" sales mechanisms. In BancoSol, specialised sales teams explain the details of microinsurance products to clients to free up loan officers' time. In Colombia, FASECOLDA has teamed with the government to provide financial education to target clients for microinsurance in order to help build awareness of the benefits of these products. Panamanian insurers from SAGICOR and Pan American Life participated in the discussion. These insurers believed that there is both a market and social rationale for entering this market and that it would be important to develop long-standing relationships with clients by offering more than only life and funeral insurance.

Luis Della Toga, Panama's Superintendent of Insurance and Re-insurance participated in the Forum, highlighting the authorities' interest in integrating some important aspects of microinsurance into the new Insurance Law which is currently under discussion. Mr. Armando Cáceres, Superintendent of Insurance for Peru's Bank and Insurance Superintendency provided the example of innovative legislation in Peru that facilitates microinsurance by permitting greater flexibility in contracts and processes for microinsurance and eliminating the requirement that licensed intermediaries participate in this market. Peru's experience has shown that with more appropriate regulation, the market can reach more remote populations through non-traditional channels.

Nevertheless, the insurance companies have found ways to offer microinsurance in countries without special legislation as in the case of Colombia. To close the Forum, some of the region's top MFIs had an open discussion on how to move forward. Gloria Ruiz, Director of Pro Mujer Nicaragua highlighted that insurance companies should be knocking on their door to ask what their clients need. To date, her experience has been that insurers only offer products that are only "downscaled" versions of their traditional products. According to Ms. Ruiz, MFIs, and in particular those who work with groups such as Pro Mujer are closest to the target market and can be effective delivery channels. Julio Flores, General Manager of FDL in Nicaragua and President of REDCAMIF noted that microinsurance is a key component to providing integrated financial services to the poor. While many MFIs, in particular in Nicaragua, have been distracted by the current difficult situation, "it will not last forever" and MFIs need to think ahead and begin to work on microinsurance. Fabio Martinez from Banco Delta in Panama noted that while the bank is only offering mandatory products, it's a good start as they build knowledge about these products. Over time, the Bank can expand and offer additional, voluntary services. Anibal Montoya, General Manager of FUNED VisionFund OPDF in Honduras expressed concern that there were few examples of effective crop insurance, an important need in rural Honduras.

The Forum was an exciting first step in promoting microinsurance in the region and sharing important experiences that can be applied to its microinsurance programme initiatives. Donor agencies including the ILO's Microinsurance Innovation Facility, the Interamerican Development Bank / Multilateral Investment Fund and the Andean Development Corporation participated throughout the event to lend their expertise and support. Understanding the benefits of microinsurance on protecting the hard-earned assets of the poor is essential, but without an understanding of the critical steps needed to ensure that these programmes are effective, there cannot be a market for microinsurance in the region. The Forum was the first step toward the development of this market.

Author:

Barbara Magnoni (magnoni.barbara@gmail.com)

For more details visit: www.foromicroseguros.org

NETWORK NEWS

MICROINSURANCE NETWORK LAUNCH

The Microinsurance Network was officially launched in Luxembourg during the opening session of the European Microfinance Week on Tuesday, 24 November 2009, by the Minister of Cooperation and Action Aid Marie-Josée Jacobs. Craig Churchill, ILO and chair of the Microinsurance Network, thanked the Minister for this opportunity and continued to highlight the challenges for promoting good value microinsurance that should be addressed by microinsurance stakeholders as well as by European Microfinance Platform members.

INTERNATIONAL MICROINSURANCE CONFERENCE

The 5th International Microinsurance Conference, organised by Munich Re Foundation and the Microinsurance Network, was held in November 2009 in Dakar, Senegal, and brought together nearly 400 experts and practitioners from 64 countries to discuss new approaches for the provision of affordable insurance products to the world's poor. In a new cooperation venture with the renowned "Journal of Risk and Insurance", academic researchers were invited to present their latest research in microinsurance. The conference was also awarded The Global Accelerator Award™. The 6th International Microinsurance Conference will be held in Manila, the Philippines between 9-11 November 2010.

For details visit:
www.microinsuranceconference2010.org

NEW MICROINSURANCE CALENDAR

A calendar is now available on the Microinsurance Network's website and includes all relevant microinsurance conferences, trainings and meetings.

If you know of or are organising any relevant events that have not been included, please email the details to info@microinsurancenetwork.org.

IMPACT WORKING GROUP : STOCKTAKING INITIATIVE

The Impact Working Group launched a Stocktaking Initiative website, which serves as a clearinghouse of information on ongoing impact assessments of microinsurance. The Working Group plans to continually update and add new features to this site, with the aim to include an overview of the complete impact assessments of microinsurance.

For details visit:
www.microinsurancenetwork.org/workinggroup/impact/stocktaking.php

ACCESS TO INSURANCE INITIATIVE

The Access to Insurance Initiative, launched in October 2009 and the outcome of the Microinsurance Network RSP-IAIS Joint Working Group is a new collaborative approach between international development agencies and insurance supervisors through the IAIS. This global programme is designed to strengthen the capacity and understanding of insurance supervisors, and to facilitate their role in expanding access to insurance markets.

For details visit:
www.access-to-insurance.org

MICROINSURANCE NEWS

MICROINSURANCE SUMMIT 2010

Date : 23-25 February 2010
Venue : Le Meridien, London

The Microinsurance Summit 2010, organised by conference organisers Hanson Wade, provides an opportunity for leading executives of insurance and reinsurance companies, MFIs, NGOs, development-aid agencies, multilateral development banks, and international and regional regulatory bodies to get together and discuss the needs of the market and potential solutions to make it prosper.
The summit will examine :
- Case studies of successful schemes and operational lessons.
- The future shape and direction of this market and what are the catalysts for growth.
- Different distribution models and which are working best in practice
- How to measure microinsurance with the key performance indicators for better management.
- Effective marketing and communication at the bottom of the pyramid.
- How to support and educate low income clients to boost insurance literacy.

The third day is for specific and specialised workshops.

For details visit:
www.hansonwade.com/events/microinsurance-summit-2010

ILO'S MICROINSURANCE INNOVATION FACILITY GRANTS

The ILO's Microinsurance Innovation Facility launches a new call for grant proposals. This call has a special emphasis on health microinsurance, but also welcomes applications for projects focusing on high-impact products and innovative distribution channels. Microinsurers that have the potential to provide better insurance products to many low-income people but need their capacity to be to strengthened can also receive support. The deadline for the submission of proposals is 2 March 2010. Application form is available in 3 languages.

For details visit:
www.ilo.org/microinsurance

For more news on microinsurance please visit the Network's website:
www.microinsurancenetwork.org

The Microinsurance Network newsletter is published three times per year. The Microinsurance Network is a member-based network and its mission is to promote the development and proliferation of good-value insurance products for low income persons by providing a platform for information sharing and stakeholder coordiantion with the aim of creating public goods.

To suscribe to this publication in English, French or Spanish, send an email to info@microinsurancenetwork.org
To view all the back issues and other Microinsurance Network publications, visit its website at www.microinsurancenetwork.org

This publication is edited by the Microinsurance Network / ADA asbl.