



"Creating Partnerships to Insure the World's Poor"

MicroInsurance Centre Briefing Note # 1

The Lure of MicroInsurance: Why MFIs Should Work with Insurers

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Introduction

It is clear from all the conferences, meetings, and discussions on MicroInsurance that this topic has become "hot" in the development community. At the same time, there are institutions (especially MFIs) with very limited capacity moving into this arena and offering insurance products directly to their clients. Much of this provision remains on the level of basic credit life (loan coverage) policies, which are simple enough for them to manage. However, many institutions are contemplating, or have already made, a move to provide more advanced and risky types of insurance, and this can have an extremely detrimental impact on an MFI.

There are ways to satisfy risk management needs of clients without exposing an MFI to significant insurance risk. Clearly the first approach by MFIs should include savings and emergency loan products. These are much easier to provide and fall within the core activities and capacities of most MFIs. A later option could be the provision of insurance in partnership with a formal insurer. It is this latter option that is addressed in this Briefing Note.

Interest in MicroInsurance versus MFI Capacity

As the provision of insurance products gains further publicity, more MFIs will inevitably try to enter this market. Many of these MFIs already experience difficulties simply offering their core product – credit. There are relatively few MFIs that have reached financial sustainability, and there are even fewer that have successfully integrated a savings component into their product line. Some MFIs with weak loan portfolio quality actually state that they offer savings products so that they can fund their dying portfolios. There is no reason to expect any different response from these institutions entering the insurance business, a business that promises to provide at least an initial positive cash flow. This strategy puts both the insurance business and the microfinance business at significant risk.

Why Worry about MFIs and MicroInsurance?

MFIs and donors should tread very carefully into this new and exciting realm for four main reasons:

First, it is important to recognize that an insurance product is not just another financial product – **it is an entirely different business** requiring significantly different institutional capacity, skills, and experience, including specialized risk management techniques, and analytical abilities, among others.

Second, it is **dangerous to mix insurance provision with financial services**. In most countries, financial institutions and insurance companies are supervised by distinctly different organs of government. There are good reasons for this. Even in the USA, with its highly regulated financial services industry, banks were prohibited by law from taking on insurance risk. The concern was that losses from the non-banking business activities would negatively influence the banking business and put deposits at much greater risk. Now that modern advances in technology allow for better control of the separate businesses, the policy of "separation banking" has been recently reversed. Still, for over sixty years this law was applied to competently regulated and supervised financial institutions. This is much different from the unregulated NGOs with unclear ownership structures and all capacity focused on credit provision and savings oversight.

Third, proceeding into any new business without a full and honest assessment of one's own capabilities, and in the case of insurance a comprehensive risk analysis is contrary to sound business practices. A rational approach to starting any new business is that company management identify a market need, develop a product concept, assess potential demand, and then assess its own abilities to manage the business at a profit. However, the development world, and the MFI "industry" in particular, too frequently does not work on this rational model. The appeal of **donor funds**

tends to skew the incentive structure for many organizations. This leaves the definition of a “potential market” for a new product obscured. (Is the market the “poor,” or the donor? Too often, it is the latter.) A self-assessment on the ability to manage a new business in which a positive assessment leads to potentially significant donor money, and a negative assessment is perceived to be giving money away to others, is likely to be biased.

Fourth, **regulation, supervision, and appropriate controls are significant factors.** It is important to recognize that very few MFIs are regulated for their credit and savings activities and the vast majority are not supervised at all. Technology is still often only minimally existent. MFI institutional controls, as well as controls over managers, are traditionally weak, as are boards and external audits. MFI capacity building has been intensive but specifically focused on and around credit and savings oversight (and more recently intermediated savings). In virtually every country, acting as an insurer requires coming under regulatory control, and any organization holding insurance risk without a license is operating illegally.

Entering into the new business of insurance with its substantially different risks and requirements, on top of the demands of an ongoing microfinance business, has the **potential to destabilize an already somewhat fragile “industry”** that in most cases continues to contend with the unsettled state of its core products. The financial systems approach that has defined much of the MFI “industry” doctrine for years promotes focusing on core products, and not diverting into other business areas. There is little reason to shift from this strategy for the sake of MFIs becoming insurers. There is another way to satisfy client demands but protect MFI integrity.

A solution at hand, and an historical comparison

At a similar point in the development of micro credit programs it was argued, correctly, that banks simply were not interested in the micro market because of access difficulties. MicroInsurance is a different case. Insurers throughout the world are increasingly interested in this market as long as they can overcome the client access difficulties. Client access is precisely what MFIs can effectively provide. Major international insurers like AIG, Allianz, and AXA, and national insurers like New India Assurance, and AAR in Kenya, have shown keen interest in accessing this market through MFIs. There is no need now for taxpayers to pay for MFIs to become insurance companies when expert capacity is potentially available.

Where to focus?

Institutions that have identified client demand for insurance products should focus on creating partnerships in which an MFI works with a regulated insurer to provide clients with an insurance product adapted for the micro market. Such partnerships facilitate MFI provision of insurance products to clients while virtually eliminating risk to the MFI, dramatically minimizing their administrative burden, and requiring very little capacity building on the part of the MFI. Additionally, while facilitating customer interactions for the insurer (sales and basic servicing), the MFI should earn commissions. All parties – the insurer, the MFI, and their clients – can benefit from the potential power of insurance, without destabilizing the MFI or distracting it from its core business.

Other options?

Mutual insurance schemes, including those promoted by ILO/STEP and CIDR, are another option that might satisfy the same detachment objectives, although they often experience significant problems (mostly related to the conflict between the need for a large population of insured, in order to spread the risk, and the limited capacity of management, coupled with the fact that the total risk lies with the membership). Another lesser option is that of outsourcing various aspects of the insurance business, such as underwriting and reinsurance. Subcontracting these responsibilities will limit the in-house capacity requirements, but management must still supervise the work of the consultant since all of the risk remains with the MFI. Finally, providing credit life insurance on the institution’s portfolio can be a manageable product and is most easily done if the benefits are limited to coverage of the outstanding loan principal and interest.

Conclusion:

Insurance is a different business for MFIs, not just a different product. Those who already provide risk management savings and loan products, and still identify an effective demand from clients for insurance products, should look towards an insurance provision partnership with formal insurers. In such a relationship the insurer maintains the insurance risks and the MFI provides sales and basic servicing for the products – both doing what they do best.