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A field study of microinsurance in the Philippines

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Foreword

This work on microinsurance in the Philippines was carried out with the generous funding of the Dutch Government as part of its Partnership Program with the ILO. The report is part of larger multi–country project that seeks to understand how low-income entrepreneurs cope with risk in securing a livelihood and the role that insurance can play in managing risk.

Low-income entrepreneurs are particularly vulnerable to risk. While many of the risks appear to be in principle insurable, little insurance is available to them. A major reason, of course, is that insurance is one of the most difficult of all financial services to provide. Insurers face risks getting the prices wrong, fraud, moral hazard and adverse selection. Those who provide insurance to low-income entrepreneurs, face the additional challenge of trying to cover their costs (and make a profit) through the sale of relatively low-cost insurance policies. Against this background it is particularly noteworthy that a few microfinance institutions have begun to add microinsurance to their product lines.

This paper presents the results of an extensive survey of the risks faced by Philippino microentrepreneurs. The authors argue that many of the risks would be best addressed through non-insurance means, but that insurance is appropriate and viable in the management of certain risks for example, the death of a member of a household enterprise. The authors provide a fascinating account of the emergence of microinsurance based on indigenous "insurance like" mechanisms. In addition to analysing risks and microinsurance schemes, this paper, with its extensive overviews of the Phillipino microinsurance industry, will serve as reference guide for donors, MFIs and other parties who currently work or intend to work on microinsurance in the Philippines.

The Social Finance Programme has taken a lead role among international agencies in exploring and promoting the prudential use of microinsurance as a new instrument in their microfinance toolkit. The InFocus Programme on Boosting Employment through Small Enterprise Development (IFP/SEED) aims to ensure that low-income entrepreneurs have access to social services and protection. This research indicates that a viable strategy for achieving this is by delivering microinsurance through microfinance institutions. The lessons identified in the research project have been incorporated into a training manual developed jointly by the InFocus Programme on Boosting Employment through Small Enterprise Development (IFP/SEED) and the Social Finance Programme (SFP). The manual will be used in training the managers of MFIs in developing and managing microinsurance products

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Acronyms

ACDECO	-	Angono Credit and Development Co-operative
ASKI	-	Alalay sa Kaunlaran sa Gitnang Luzon, Inc.
BLISS	-	Basic Life Insurance Security System
BSP	-	Bangko Sentral ng Pilipinas
CARD	-	Center for Agricultural and Rural Development
CISP	-	Co-operative Insurance System of the Philippines
CLIMBS	-	Co-operative Life Insurance and Mutual Benefit Society
CLPP	-	Co-operative Loan Protective Plan
CLSP	-	Co-operative Life Savings Plan
CMPC	-	Co-operative Members Protection Plan
COPS	-	Co-operative Officers Protection Plan
CPA	-	Comprehensive Personal Accident
CUP	-	Co-operative Union of the Philippines
ECP	-	Employees Compensation Program
FIES	-	Family Income and Expenditure Survey
FSP	-	Fisheries Sector Program
GDP	-	Gross Domestic Product
GFI	-	Government Financial Institutions
GNP	-	Gross National Product
GSIS	-	Government Service Insurance System
GYRT	-	Group Yearly Renewable Term
HMO	-	Health Maintenance Organisation
LPPI	-	Loan Payment Protection Insurance

MATF	-	Mortuary Aid and Trust Fund
MBA	-	Mutual Benefit Association
MFF	-	Members Mutual Fund
MFI	-	Microfinance Institutions
MMG	-	Medical Mission Group
MPC	-	Multi-Purpose Co-operative
MYRACL	-	Member's Yearly Renewable Accident C-Life
NATCCO	-	National Confederation of Co-operatives
NAPC	-	National Anti-Poverty Commission
NBFI	-	Non-Bank Financial Institutions
NCC	-	National Credit Council
NGO	-	Non-Government Organisation
NHIP	-	National Health Insurance Program
NSCB	-	National Statistics Coordination Board
NTNC	-	National Trade Union Congress
PCIC	-	Philippine Crop Insurance Corporation
PCE	-	Personal Consumption Expenditure
PCFC	-	People's Credit and Finance Corporation
PDC	-	Pandacan Development Co-operative
PDTF	-	People's Development Trust Fund
PFCC	-	Philippine Federation of Credit Co-operatives
PHIC	-	Philippine Health Insurance Corporation
RBAP	-	Rural Banker's Association of the Philippines
ROSCAS	-	Rotating Service and Credit Associations

SAMULCO	-	Sta. Ana Multi-Purpose Co-operatives
SMBS	-	SAMULCO Mutual Benefit System
SME	-	Small and Medium Enterprises
SPEC	-	Southern Philippines Education Co-operative Center
SSS	-	Social Security System
SWS	-	Social Weather Station
TUCP	-	Trade Union Congress of the Philippines
UNICO-OP	-	Unified Co-operative Investments, Inc.

1.0 Executive Summary

Microfinance institutions (MFIs) in the Philippines have created innovative mechanisms to address the financing needs of low-income families and entrepreneurs. Most recently, some MFIs have begun experimenting with microinsurance as means of reducing their clients' vulnerability to a range of risks. To learn about these nascent activities, this study maps the microinsurance landscape and establishes knowledge on the regulatory framework for insurance in Philippines; identifies the details of microinsurance operations; and examine the demand for insurance by micro and small enterprises (MSEs).

There are three types of organisations currently providing microinsurance in the Philippines. First, there are MFI-owned insurance companies that offer formal insurance to small and micro entrepreneurs through their co-operative members. The biggest among these insurers is the Co-operative Insurance System of the Philippines (CISP) and Co-op Life Insurance Mutual Benefit Systems (CLIMBS). The second source for microinsurance is the co-operatives themselves, which sometimes prefer to offer their own insurance products rather than serve as an agent for the MFI-owned insurers. Third, there are NGO-MFIs that may offer insurance on their own or as an agent for an insurer.

The insurance services available through these MFIs are limited to credit-life, life insurance, and health insurance. Credit-life is the most widely available, perhaps because it primarily reduces the risk of the MFI. Life insurance is also common, often based on the traditional practice of *damayan* where relatives and friends in the community voluntarily contribute cash to the dependents of an individual who passed away. Health insurance was only available from a few organisations that have offered it for a short period of time. Based on the experiences of the MFIs in delivering these products, a number of useful lessons emerge about ways to minimise transaction costs, reduce adverse selection, and manage other insurance risks.

This study attempted to quantify the risks and vulnerabilities of persons operating micro and small enterprises. The three risks that emerge as the greatest concerns for MSE operators

are: 1) illness or accident of the entrepreneur or a family member; 2) natural calamities such as typhoons; 3) basic business risks such as high competition and low demand. While insurance may be an appropriate tool to manage the first two risks, the third is probably best addressed through training and other business support services. In general, entrepreneurs had a positive attitude about insurance and its potential to reduce their vulnerability, perhaps because of their familiarity with *damayan* schemes.

The gap between the supply and demand for insurance is clear. There is a need to improve the quality and availability of health insurance, and to develop disaster insurance. These represent enormous challenges for the microinsurance industry in the Philippines. Significant investments in microinsurance training, research and development, as well as discussions about preliminary microinsurance regulations are required to narrow the gap.

Just as microfinance has gained widespread acceptance as an effective development strategy; microinsurance, too, promises to be a sustainable approach to risk management for the informal sector. MFIs are currently in the best position to provide microinsurance to the informal sector and should actively experiment and innovate to make the mainstreaming of microinsurance a reality.

This paper is organised into eight parts including the Executive Summary. Section 2 introduces the study and provides background information about the Philippines. The third section describes the formal and informal financial sectors and the regulatory environment. Section 4 provides an overview of the insurance industry in the Philippines. The fifth section introduces the MFIs in this research, describes the insurance products that they offer, and analyses key differences based on the type of institution. Section 6 presents the results of the MSE survey that investigates the risks and coping strategies of entrepreneurs. Based on these findings in Sections 5 and 6, the seventh section develops a framework for analysing microinsurance and Section 8 summarises the major lessons learned.

2.0 Introduction

Social development organisations in the Philippines, particularly microfinance institutions (MFIs) have created innovative mechanisms to address the financing needs of low-income families and entrepreneurs. They have proven that poor families and entrepreneurs have the capacity to save and improve their overall well-being given the appropriate financial support.

Given the success of MFIs in providing credit and savings facilities to low-income families and entrepreneurs, the next question is whether MFIs can provide low-cost insurance for this same group.

Micro and small entrepreneurs (MSEs) have shown that they can contribute to the growth of Philippine economy. Their strength lies in their number and in their huge contribution to the country's Gross National Product (GNP). A major weakness, however, lies in their exposure to a variety of risks.

Over the years, a number of Philippine MFIs have provided microinsurance products to MSEs, and have continually developed innovative mechanisms to fit the needs and the paying capacity of their clients. Several MFIs that have responded to these needs are examined in detail in this paper. Studying their efforts provides a valuable opportunity to learn more about the emerging practice of microinsurance.

2.1 Objectives and Methodology of the Study

This study aims to:

i. Map the microinsurance landscape and establish knowledge on the regulatory framework for the insurance industry in Philippines.

ii. Identify the details of microfinance operations for the provision of insurance, with specific interest in what difficulties they have faced.

iii. Examine the demand of micro and small enterprises for insurance.

Primary data was gathered through key informant interviews, a survey of MSEs, and case studies. MFIs for the case studies were selected on the basis of having provided microinsurance for at least one year. Of the twelve MFIs approached for the case studies, six were able to accommodate the researchers.

A desk review of secondary documents was done to establish the regulatory framework of the insurance industry.

2.1 Background on the Philippines

Demography: The Philippines is a tropical country located in Southeast Asia. The country has a total land area of approximately 300,000 sq. km. (115,830 sq. miles) and 7,107 islands. It is the second largest archipelago in the world, next to Indonesia, and is divided into three major island groups: Luzon, Visayas and Mindanao.

The country is divided into 16 regions and has a total of 78 provinces, 67 cities, 1,539 municipalities and 41,296 barangays (villages). The seat of power is in Metropolitan Manila.

Table 2-1. Population of the Philippines

Estimated total population (in millions)	76.4
Population density (inhabitants per square kilometer)	255
Average annual population growth (%)	2.32

Source: National Statistics Office, National Statistics Coordination Board, Population Census:1995

According to National Statistics Coordination Board (NSCB) estimates, with a growth rate of 2.32%, population is expected to double in 29 years.

Socio-economic Summary: Poverty data showed a disparity of incomes and well being across the country. According to the NSCB, national poverty incidence was estimated at 32.1%. In 1994 the country's human development index was 0.66.

Based on the 1997 Family Income and Expenditure Survey (FIES), Filipino families had an average annual income of P123,168 (USD 2,463.36) and an average annual expenditure of P 99,537 (USD 1,990.74). These figures can be misleading, as there was an uneven distribution of wealth in the country. The overall Gini coeffecient of the Philippines was 0.45 in 2000. As such, wealth in the Philippines was concentrated in a small fraction of the population and families on the lower end of the income scale earn far less than what the average suggests.

The Asian economic crisis had tangible negative effects on the country. The unemployment rate increased from 7.9% in 1997 to 9.6% in 1998 and the economy had to struggle with the effects of inflation (5.9% in 1997, 9.0% in 1998, and 11.5% in 1999), decreasing foreign investment, and outflow of capital.

Table 2-2 shows the growth rates of gross domestic products (GDP), gross national products (GNP) and personal consumption expenditure (PCE) from 1999-2000.

Table 2-2. Philippine GDP, GNP and PCE in year 1999-2000

	1999	2000	Growth rate
GDP	39,025	42,370	8.6%
GNP	41,100	44,697	8.8%
PCE	28,154	29,779	5.8%

Source: National Statistics Office, National Statistics Coordination Board, National Accounts: Fourth Quarter 2001

At present, the Philippines is in an unstable political and economic situation. For the past two years the country had been confronting political turmoil and economic slowdown. In January 2000, the former president was accused of plunder, and was removed from office. As a result, the value of the Philippine peso fell against the US dollar to its lowest level. The

exchange rate hovered at P50 to the US dollar. In addition, the country's external debt to the World Bank and other financial institutions amounted to 40 billion USD (in 2000).

History: The Philippines had a diverse mix of cultural influences. Though dominantly Malay in origin, many Filipinos traced their roots to the Chinese, Indians, Arabs, Spaniards and the Americans.

Before the Spanish came to the country, there was no national-state but a collection of villages scattered across the islands. These villages were closed, self-contained political, socio-economic and ecological systems. They have created indigenous solidarity mechanisms to mobilise individuals and households to address individual and community needs. In a non-cash economy, services and goods were exchanged based *not solely* on the principles of the market, but also on customs, reciprocity, and mutually beneficial collective action. Many traditional schemes of mutually beneficial collective action and solidarity mechanisms that existed during the pre-colonial period form the basis of today's microinsurance.

Arriving in 1521, the Spanish brought an overlay of formal institutions such as the government bureaucracy, trading companies and the Roman Catholic Church. Americans came in the late 19th century and maintained key components on the Spanish bureaucracy. They installed even more institutions such as the bicameral legislature and the educational system. Other modern institutions such as corporations, and among them formal insurance companies, began to dominate the local market.

3.0 Microfinance in the Philippines

This section begins with an introduction to the formal and informal financial sectors in the Philippines. It concludes with an overview of the regulatory environment for microfinance.

3.1 Overview of the Financial Sector

3.1.1 The Formal Financial Sector

Formal finance in the Philippines consists of banks and other non-bank financial institutions (NBFIs) regulated by the Philippine Central Bank or *Banko Sentral ng Pilipinas* (BSP). Banking institutions are composed of universal, commercial, thrift and rural banks, which differ in the financial services they offer and their target clients.

Universal banks, also known as expanded commercial banks, have the authority to exercise the powers of investment houses; that is, invest in the equity of companies engaged in businesses not related to banking. They can also invest in the equities of allied and non-allied enterprises.

Commercial banks can receive deposits; buy and sell foreign exchange; and lend money on a secured or unsecured basis. Their services include accepting drafts and issuing letters of credit; discounting and negotiating promissory notes, bills of exchange and other evidences of indebtedness. These banks serve the medium and large enterprises.

Thrift banks' primary service is to provide short-term working capital and medium-and long-term financing to businesses engaged in agriculture, services, and other industries. Thrift banks cater to small and medium-sized enterprises and individuals.

Rural banks are mandated under Republic Act 720 of 1952 to make credit available and readily accessible in the rural areas on reasonable terms. They are primarily organised to meet the credit needs of farmers, fishermen, co-operatives and merchants.

Non-bank financial institutions include lending institutions and pawnshops. A profile of the Philippine Banking Sector is provided in Table 3-1.

Table 3-1. Number of Financial Institutions in the Philippines

Type of Financial Institutions (FIs)	Total	Head Office	Other Offices
Supervised/ Regulated FIs	16,615	6,049	10,566
I. Banks	7,643	974	6,669
Rural and Co-operative Banks	1,880	805	1,075
Commercial banks	4,340	52	4,288
Thrift banks	1,423	117	1,306
II. Non-Bank Financial Institutions (NBFIs)	8,956	5,061	3,895
a. With Quasi-Banking Functions	42	12	30
Investment Houses	30	7	23
Financing Companies	12	5	7
b. Without Quasi-Banking Functions	8,914	5,049	3,865
Investment Houses	33	26	7
Financing Companies	51	42	9
Investment Companies	10	10	
Securities Dealers and Brokers	22	22	
Lending Investors	13	13	
Pawnshops	8,592	4,829	3,763
Venture Capital Corporations	4	4	
Government Non-Bank Financial Institutions	2	2	
NSSLAs	171	85	86
BLAs	6	6	
Credit Card Companies	10	10	
III. Offshore Banking Units	16	14	2

Source: Rural Bankers' Association of the Philippines, Briefing document: March 2000

3.1.2 The Informal Financial Sector

The informal financial sector consists of institutions engaged in financial intermediation that are not regulated and supervised by the BSP. Informal institutions have emerged to fill the

gap in the demand for financial services in both rural and urban communities where the formal sector fails to operate or where its services do not met the needs of low-income clients.

Informal systems such as the "*paluwagan*" or borrowing from private moneylenders and the Rotating Service and Credit Associations (ROSCAS) are used as alternative solutions by individuals shunned by the formal institutions. Usually, microentrepreneurs and other informal sector operators belong to this classification. They are perceived as high-risk debtors due to the size and nature of their businesses, which are vulnerable to external shocks, generally lack collateral and require high transaction costs. Consequently, informal sector operators have turned to the financial services provided by co-operatives, non-government organisations (NGOs), private moneylenders, and people's organisations. The scale of informal finance in the country was highlighted by the study conducted by the Social Weather Station and the Ateneo de Manila University, which showed that of the total voting population that borrowed in 1987, as much as 66% resorted to informal sources of credit.

Microfinance institutions (MFIs) are financial institutions that provide financial services to the poor. They are called "micro" because of the small size of their transactions; they grant loans as small as USD 50 and accept savings as small as USD 5. Some MFIs are also engaged in microenterprise development as a means of improving the situation of their poor clients. There are two types of microfinance institutions in the Philippines, the co-operatives and the non-government organisations (NGOs).

Co-operatives have grown rapidly and have been particularly successful in financial intermediation for low-income communities. As banks generally do not offer services to these communities, co-operatives have stepped in to satisfy the demand. These engines of development in the countryside have the distinct advantage of their familiarity with the local population. However, problems have arisen with the co-operatives' capacity for financial management, proper governance, and the limited variety of services offered.

Table 3-2. Statistical Information of All Types of Co-operatives (1985 to 1993)

	1985	1993	% Increase (Decrease)
Total Registered	3,350	21,125	750.0
Samahang Nayon (SN)	4,496	–	--
No. of Reporting/Confirmed Co-ops	1,142	4,494	393.5
Credit co-ops	592	1,095	184.9
Consumer	305	290	(4.9)
Producer	65	118	181.5
Marketing	87	160	183.9
Service	35	180	514.2
Multipurpose (agricultural)	27	2,189	8,107.4
Multipurpose (non-agricultural)	--	334	--
Area marketing	17	16	(5.8)
Co-op bank	29	29	--
Co-op federation	--	40	--
Co-op union	--	43	--

Source: University of Wisconsin Centre for Co-operatives, A Century of the Philippine Co-operatives, Table 3.

NGOs are also involved in informal finance. A 1998 study conducted by Meliza H. Agabin commissioned by the Coalition for Microfinance Standards concluded that, although the NGO sector is the smallest in number, with only 300 NGOs, it has amassed significant assets. NGOs served approximately 177,000 active borrowers, or about 1.5% of all households.

3.2 Regulatory Framework for MFIs

The regulatory framework for microfinance in the Philippines is directly related to the Philippine government's poverty alleviation policies. In the 1970s and 1980s, the government created direct credit and guarantee programs specifically targeted at the impoverished portion of the population, which primarily involved the agricultural sector. However, these programs failed to reach the intended beneficiaries. The government then instituted financial reforms as it pursued market-oriented interest rates, the termination of subsidised re-discounting by the

Central Bank, consolidation of existing agricultural credit programs and termination of direct agricultural lending by government agencies. Although these reforms were primarily targeted at the agricultural sector, there was also a resulting decrease in subsidised credit programs for small and medium enterprises.

Due to these developments, the National Credit Council (NCC) was created on October 1993 through Administrative Order No.86. The NCC had the following goals and objectives:

- to rationalize and optimise all government lending programs;
- develop a national credit delivery system;
- encourage private sector participation; and
- to define and rationalize the role of guarantee programs and guarantee agencies.

The NCC also formulated a set of Policy Guidelines for Credit Programs that were intended to discontinue all government-lending programs.

The Social Reform and Poverty Alleviation Act (Republic Act 8425), which was passed in 1997, was landmark legislation for microfinance. It recognised microfinance as the central strategy for poverty alleviation. The act started the People's Development Trust Fund (PDTF), a governmental support system for capacity building of MFIs. Unfortunately, nothing worth noting had resulted from the PDTF and its implementation had been effectively halted.

RA 8425 also recognised the role of the People's Credit and Finance Corporation (PCFC) in addressing the credit and savings needs of the poor. PCFC's primary role was to mobilise resources and deliver financial services to the MFIs. As of June 30, 1996 PCFC had supported 73 non-government organisations (NGOs), people's organisations (POs) and private financial institutions (PFIs) in the implementation of their credit assistance programs intended to fund livelihood/income generating projects of poor self-help groups members. Total credits of P 171,931,042 (USD 3,438,620) have been released benefiting 25,262 borrowers.

The rationale for the creation of PCFC stemmed from a People's Empowerment Caucus, held on June 17, 1994 that acknowledged the important function of credit in empowering the basic sectors. It was part of the mechanisms to address the provision of credit as mandated in the master plan of the Credit for the Poor program of the Presidential Commission to Fight Poverty (PCFP). PCFC was then established on February 9, 1995 under the supervision of the Landbank and PCFP. PCFC was registered with the SEC on September 14, 1995 with an authority to operate as a finance company. It has an authorised paid up capital of P 100 M (USD 2 M).

Apart from allowing access to livelihood and income generating activities for the poor, PCFC also provided a lending window for eligible conduits that use various credit delivery systems that are replicable, self-sustaining, operationally viable, and proven effective in servicing the credit needs of the poor in their areas of operation. The PCFC also gives institutional building support to NGOs, POs and PFIs that on-lend funds to members of poor communities to finance income-generating projects.

Another recent development in the MFI regulatory framework was the issuance of the *Bangko Sentral ng Pilipinas* (BSP) Draft Memorandum related to MFIs in December 2000. This draft memorandum classified all loans below P 150,000 (USD 3,000) as part of the microfinance sector. The BSP also urged and enticed banks to venture into microfinance by opening a rediscounting window for microfinance. This rediscounting window offered lower interest rates, one percent below national treasury bills. The PCFC however, opposed the BSP's draft memorandum, as they believed that this would only result in the duplication of functions on the part of the government financial institutions and the rural banks.

3.2 MFI Regulatory Agencies

The entry of MFIs into the financial system prompted the creation of microfinance standards to promote accountability. The creation of standards is an attempt to ensure that the

services offered by MFIs were both reliable and viable.

The Microfinance Council of the Philippines is a federation of MFIs, mostly NGOs, created in 1997. Its members include some of the biggest MFIs in the country, which include the Center for Agriculture and Rural Development (CARD) and the ABS-CBN Bayan Microfinance. The Council has the following membership criteria: 1) a mission statement that includes a vision for the poor; 2) at least 3, 000 clients; 3) a minimum portfolio of P10 million (USD 200, 000); 4) a three-year track record; 4) a manual of operations and a management information system; 5) membership fees and dues; and 6) SEC documents for corporations.

The World Council of Credit Unions (WOCCU) has helped Philippine co-operatives achieve some level of standardisation through its Credit Union Empowerment and Strengthening (CUES) Program. The 3-year program aimed to make Philippine co-operatives achieve world-class status by introducing standard financial systems and policies.

4.0 The Insurance Industry in the Philippines

In this section, the historical, legal, and regulatory aspects of the insurance industry are discussed.

4.1 Indigenous and Formal Insurance

Insurance in the Philippines can be classified according by the historical origin of the insurance technologies. Not only do formal and indigenous insurance have different roots, but they also serve clients of different income levels.

4.1.1 Formal Insurance

Formal insurance was introduced in the early 19th century during the Philippines' colonial periods. Formal insurance largely originated from the West by foreign insurance firms catering to the Philippine market. Non-life insurance was introduced to the Philippines when Satcham, Murray and Co. and began operations in the country in 1829. Sun Life Insurance of Canada started life insurance in the Philippines in 1895.

These services were based on the insurance sciences developed abroad, particularly from countries with a long history of formal insurance such as Europe and North America. Formal insurance companies were modelled after large, profit-oriented insurance companies that sold policies to individuals and companies. In terms of technologies, the formal insurance companies utilise actuarial science, financial management and reinsurance concepts to run their systems.

In terms of scale, the players in formal insurance have a large number of policyholders ranging from tens of thousands to hundreds of thousands. The target markets of these firms are in the middle and upper income brackets. Formal insurance does not cater to the informal sector because of the insurers' unfamiliarity with this segment of the population and the absence of tools and skills to manage the relatively high risks and transaction costs involved in serving this market.

The Insurance Commission regulates formal insurance firms and ensures the financial and actuarial soundness by mandating minimum requirements in terms of capitalisation and standards for prudence in risk management. The Philippine Health Insurance Corporation and the Department of Health regulate formal health insurance.

Generally, these policyholders have no sense of ownership over the insurance firm. The sense of solidarity is low because the policyholders are strangers to each other. The insurance relationship is impersonal and is basically guided by the policy written in the insurance contract.

4.1.2 Indigenous Insurance

The practice of microinsurance in the Philippines is not new. Risk-sharing and other forms of risk management through solidarity schemes have been part of Philippine community life for centuries. In the subsistence economy of the past, risk-sharing and resource-pooling customs were developed so that individuals and groups could cope with the occasional crises that befell them.

One of these risk-sharing customs that remains prevalent is the practice of *damayan* where relatives and friends in the community voluntarily contribute cash to the dependents of an individual who passed away. The *damayan* has become the basis of risk-pooling schemes for life insurance and is common among co-operatives and associations. In this self-insurance scheme, group members agree to shift the risk from one individual to the group, which manages and owns the risks collectively.

As will be shown in Section 5, many MFIs trace their insurance schemes to the *damayan* that their members instinctively practiced as part of the local customs. After some time, their *damayan* was institutionalised and labelled as "life insurance" by the MFIs, along with the installation of some policies to make the custom of *damayan* binding and compulsory.

These *damayan*-based schemes are based on solidarity and sharing. Relationships within the *damayan* group are personal. "Contributions", rather than premiums, are collected and are given as gifts, rather than claims, from the community to the bereaved. The implicit threat of ostracism serves to enforce participation and significantly reduce the problems of moral hazard and adverse selection.

Indigenous insurance is usually small scale, covering a few dozen to a few thousand members. Such schemes work well for lower income groups because they cannot afford formal insurance policies. Informal insurance schemes are largely unregulated, which allows for site- and client-specific customisation at the local level.

In terms of technology, indigenous insurance predominantly uses social mobilisation,

community organising, indigenous customs, and social capital. It is important to note at this point that most of the cases studied can be thought of as hybrids, or semi-formal, having qualities of both indigenous and formal insurance. Mutual Benefit Associations (MBAs) fall within this category.

Mutual Benefit Associations are insurance schemes run on a not-for-profit basis, which exist for the purpose of helping their members. MBAs are also regulated by the Insurance Commission and are required to engage the services of an actuary for the purpose of their insurance functions.

Such schemes are often managed by co-operatives and NGOs. The sense of ownership is high, especially among co-operative members because they know where their money goes, why, and how it is managed. There is often high face-to-face contact among those in the risk pool. The nature of the relationship is personal particularly in the smaller and longer-running schemes.

Table 4–1. Indigenous vs. Formal Insurance

	Indigenous Insurance	**Formal Insurance**
Origin	Traditional risk sharing custom	Insurance sciences from abroad
Players	Co-ops and NGOs	Formal insurance, for profit, and MFI-owned insurance corporations
Technology	Social organisation, social capital, social mobilisation, community organising, indigenous customs	Actuarial sciences, financial management, reinsurance
Scale	Small	Large
Target market	Lower income	Middle and Upper income
Regulation	None. Unregulated, allows site-specific customisation	Insurance Commission - ensures financial and actuarial soundness, favours big formal insurance firms
Sense of ownership among members	High	Low
Sense of Solidarity	High	Low
Nature of relationships among members	Personal	Impersonal

4.2 Regulatory Framework for the Insurance Industry

Insurance operations in most countries are subject to government intervention to ensure that they behave prudentially with the premiums they receive and fulfil their contractual obligations. In the Philippines, the Insurance Code of 1974 guides regulation. The Philippine Insurance Commission is the government agency that regulates and supervises the insurance industry in accordance with the Insurance Code. The Insurance Commission ensures that adequate insurance protection is available to the public by monitoring the insurance companies' compliance with pertinent rules and regulations. The commission also protects the financial stability of the insurance industry so that all legitimate insurance claims are met promptly and equitably.

4.2.1 Liberalisation of the Insurance Industry

After being closed for 26 years, the Philippine insurance industry was opened to new entrants, starting in 1992 with the lifting of the ban on the licensing of new domestic insurance companies. In October 1994, foreign life and non-life insurance companies were allowed to penetrate the insurance market. In March 1996, Republic Act 8179 completely opened the insurance market to all insurance companies that met the requirements set by the Philippine Insurance Commission.

The Philippine government has proclaimed its continued support of the insurance industry because insurance is expected to boost national savings and the development of a capital market. In 1997, the Insurance Commission launched the government's 20/20 vision. This aimed to increase to 20% the number of Filipinos with insurance, in whatever form by the

end of the year 2000.

The Insurance Commission is tasked with maintaining the quality of the management of insurance companies and ensuring better protection to policyholders and the public in general. It does so by prescribing minimum capitalisation requirements, qualifications of the executive officers and other key officials of insurance companies, along with the setting of risk management and financial management standards.

The minimum capitalisation for insurance firms is P100 million (USD 2 million). For MBAs to get a license from the Insurance Commission, they are required to deposit with the Insurance Commission an initial minimum amount of P10,000 (USD 200) in cash, or in government securities with a total value equal to such amount. MBAs must also comply with certain reporting requirements as well as financial management standards. Many programs functioning as MBAs, however, do not register with the Insurance Commission.

4.2.2 Regulatory Framework for Health Insurance

Health Maintenance Organisations (HMOs), which are not considered insurance companies, are technically regulated by the Department of Health. Because the Department of Health has not come up with major regulations, however, HMOs remain largely unregulated.

The Philippine Health Insurance Corporation is a government-owned corporation mandated to achieve universal coverage with health insurance by the year 2010. Though it does not have any regulatory powers over HMOs, its ability to define standards for small Community-based Health Care Organisation gives it some influence over these grassroots health organisations.

4.3 Government Insurance Programs

A number of government agencies provide insurance: the Social Security System (SSS) and the Government Service Insurance System (GSIS), the Philippine Health Insurance Corporation (PHIC), and the Philippine Health Insurance Corporation (PCIC)

The SSS and the GSIS provide life, health and disability insurance products to private and public employees respectively. In the year 2000, there were 1.3 million government employees who participated in the GSIS, and 23.2 million private employees for the SSS, including the 3.7 million self-employed individuals.

The PHIC is a government-owned and -controlled corporation mandated to implement the National Health Insurance Program. It provides health insurance to government and private sector employees. To date, 28% of the population or some 20.6 million employees and their families were covered by the NHIP.

The PCIC is tasked to implement crop insurance. As of 1998, the corporation has insured 61,285 rice and corn producers and farmers covering an area of 110,964 hectares.

4.4 Commercial Insurance Companies

As of December 31, 1999 the commercial insurance industry in the Philippines had a total of 153 authorised businesses offering life, non-life and reinsurance. The industry posted a premium production of P 34.37 billion (USD 680 million) and aggregate assets of P 183.20 billion (USD 3.66 billion). Overall, the total net worth of the private insurance companies was P 72.26 billion (USD 1.45 billion). Table 4-2 shows the profile of the commercial insurance industry in the Philippines.

Commercial insurance companies offer relatively expensive insurance products, the cheapest being P4,200 (USD 84) for an individual life insurance policy. An informal survey of the top five life insurance providers in the Philippines revealed that the average minimum policy

is 9,000 Philippine pesos (USD 180) per year or 750 Philippine pesos (USD 15) per month. With a poverty incidence of 32.1% and an average rural annual household income of P 73,319 (USD 1,466), one average life insurance policy would eat up nearly 6% of the household income. The poor populations barely have enough income to satisfy their basic needs, much less afford commercial insurance.

Moreover, transportation costs, opportunity costs, and transaction costs are extra expenses incurred by policyholders over and above the premium, further increasing the actual costs of the insurance policy.

Table 4-2. Companies Authorised to Transact Insurance Business in the Philippines as of 31 December 1999

Classification	Composite	Life	Non-Life	Professional Reinsurers	Total
A. Domestic	1	23	98	3	125
B. Foreign					
Domestically Incorporated	2	14	5	-	21
Branch	-	-	6	1	7
Total	3	37	109	4	153

Source: Philippine Insurance Commission, Annual Report: 1999.

4.5 Overview of MFI-Owned Insurance Corporations

There are several MFI-owned organisations that offer formal insurance products to MSE operators. The biggest among these insurers is the Co-operative Insurance System of the Philippines (CISP) and Co-op Life Insurance Mutual Benefit Systems (CLIMBS). The Co-operative Insurance Unification Task Force is an attempt by several MFI-owned organisations to improve insurance provision to the members of the co-operatives.

4.5.1 Co-operative Insurance System of the Philippines (CISP)

The Co-operative Insurance System of the Philippines is a national confederation of co-operatives registered with the Department of Local Government and Community Development since 1974.

CISP's main function is to provide insurance protection to the members of grassroots organisations such as co-operatives, farmers' or workers' organisations, trade unions and other co-operative-oriented groups. For 23 years, it has provided life insurance to co-operative members through the Co-operative Union of the Philippines (CUP).

CISP's specific functions were: 1) to provide low-cost insurance with social content; 2) to build a strong financial base for the co-operative movement; 3) to promote savings and self-help programs; 4) to spread co-operative ideology.

CISP is licensed to act and operate as a life insurance company and is regulated and supervised by the Insurance Commission. Membership with CISP is open to all types of co-operatives and co-operative-oriented groups by subscribing to and paying for shares of stocks. Members are entitled to all the services offered by CISP such as life insurance plans and loan insurances.

Loan Payment Protection Insurance (LPPI) – Loans from banks and other lending institutions enrolled under the LPPI may be insured for a premium of about 1% of the loan per year or less, depending upon the period of payment. In the event of the borrower's untimely death, the CISP shall pay the insured loan amount to the creditor for the reduction or outright full-payment of the debt incurred. Any excess is given to the borrower's beneficiaries. Thus, the LPPI relieves the borrower's family of the added burden of inheriting loan obligations and at the same time it assures the fast settlement of unpaid loans from credit co-operatives and co-operative banks.

Group Yearly Renewable Term Plan (GYRT) – This life insurance plan is open to the members of co-operatives, village associations, trade unions and other co-operative oriented

groups. Under this plan, members who are 15 to 65 years of age and in good health may be insured as a group for a comparatively low premium annually either on a bracketed age-premium or level premium depending on the size of the group. If an insured member dies, the beneficiaries receive the face amount of his or her insurance though the co-operative or group. Members may also purchase an Accidental Death and Dismemberment Rider and a Dependents Rider for other members of the family.

Basic Life Insurance Security System (BLISS) – This plan enhances the package of benefits offered under the GYRT. Dubbed as a buy one-take five scheme, the BLISS includes:

- Life Insurance Cover – for any cause of death
- Accidental Death Benefit
- Accidental Dismemberment Benefit
- Total and Permanent Disability Benefit – due to accidental means
- Burial Benefit – for any cause of death

The BLISS plan also includes an extra in-hospital income benefit, cash benefit while confined in a hospital for any cause.

At the end of 2000, the LPPI accounted for 77% of the CISP's total gross premiums for the year while the GYRT contributed 22%. Other plans, including the newly introduced BLISS, accounted for the remaining 1%.

The CISP currently has a membership base of 603 agricultural co-operatives, 1,002 non-agricultural co-operatives, 10 labour groups and 12,909 village associations with capital contributions amounting to P25,368,213 (USD 507,364). Total premiums collected in 2000 were P21,140,243 (USD 422,804) with total claims amounting to P4,609,210 (USD 92,184).

4.5.2 Co-op-Life Mutual Benefit Services Association, Inc. (CLIMBS)

CLIMBS was established in 1971 as an experiment in mutual protection by the

Southern Philippines Educational Co-operative Center (SPECC) and the Misamis Oriental-Bukidnon-Camiguin Federation of Co-operative. It was registered with the Co-operative Development Authority in 1992 and was later licensed as a Mutual Benefit Association (MBA) by the Insurance Commission in 1994. CLIMBS is a member of NATCCO, the biggest confederation of co-operatives in the Philippines.

CLIMBS aims to: 1) create and develop mutual protection service responsive to the needs and reaching out to the majority of the Filipinos; 2) work towards unifying the Mutual Protection Systems in the co-operative movement; 3) develop Life and Non-Life Insurance Systems; 4) serve as one of the financial sources of the co-operative movement; 5) develop and establish a dynamic educational and research program, especially in preventive medicine and health for members and the general public.

CLIMBS offered a variety of insurance products to its member-organisations, including Group Life Protection with Mutual Aid System (MAS), Co-op Life Savings Plan (CLSP), and Co-op Loans Protection Plan (CLPP). It also acted as a general agent for non-life products and had plans to offer products such as pension, educational and memorial plans in the near future.

From its initial membership of 1,769 policyholders from only six co-operatives, CLIMBS has expanded its coverage to include 124,934 policyholders from 484 co-operatives in 1998. CLIMBS recently unveiled its five-year business plan, starting in the year 2000, which is aimed at achieving a 30% growth in the period.

CLIMBS's five-year plan includes achieving full life insurance company status by 2004 with a paid up capital of P 50 million (USD 1 million); pursuing new products for new markets; offering approximately 20% return on equity to attract more co-operatives and outsiders; building a network with other co-operatives, associations, and international funding agencies. CLIMBS reversed its decision to venture into an Health Maintenance Organisation (HMO) as previously planned by the Co-operative Insurance Unification Task Force (see discussion below), but instead decided to act as an insurance broker for PhilamCare, an HMO, to meet the health financing needs of its members.

Table 4-3. Number of Policies Issued by CLIMBS as of 1998 by Product

REA	Mutual Aid System (MAS)	Co-op Loans Protection Plan (CLPP)	Co-op Life Savings System (CLSP)	Co-op Members' Protection Plan (CMPP)	Comprehensive Personal Accident (CPA)	Co-op Officers' Protection Plan (COPP)	Special Program (S. Prog.)	TOTAL
Luzon	9,748	27,284	1,851	625	94	91	781	40,474
Visayas	6,306	13,804	6,271	2,276	45	72	113	28,887
Mindanao	7,308	30,574	16,835	409	316	31	100	55,573
TOTAL	23,362	71,662	24,957	3,310	455	194	994	124,934

Source: Co-op Life Mutual Benefit Services Association (CLIMBS). Annual Report 1998.

4.5.3 Co-operative Insurance Unification Task Force

In 1997, various confederations of co-operatives and trade unions came together to create the Co-operative Insurance Unification Task Force. The participating parties were CISP, CLIMBS, the Philippine Federation of Credit Co-operatives (PFCC), and the Trade Union Congress of the Philippines (TUCP). The Task Force aimed to establish a corporation that will "combine the spirit of co-operatives and their tradition of working together with the efficiency of corporate managed enterprise." It aimed to strengthen insurance and health care servicing for both the co-operative and labour sectors.

The Task Force envisions that in the future, this proposed corporation would become the biggest co-operatively owned enterprise in the country. This initiative is still in the developmental stage. Due to economic crisis in recent years, which has badly affected the co-operative sector, the Task Force has not met its paid-up capital requirements and has yet to implement its plans.

The Task Force also intended to set up a Health Maintenance Organisation (HMO) to bring affordable health insurance products to the co-operative sector. But this plan was not implemented due to the losses experienced by the HMO industry in 1999.

Table 4-4. Summary of Players and Regulatory Agencies in the Insurance Industry

	Indigenous	Formal
Formal sector	None	*Regulator*: Insurance Commission, PhilHealth *Players:* for-profit Insurance companies, MFI-owned insurance companies, Government insurance firms
Informal Sector	• Self-regulation for non-health insurance • Co-operatives • NGO-MFIs	*Regulator:* Insurance Commission *Players:* Philippine Crop Insurance Corporation, MFI-owned insurance companies, Mutual Benefit Associations

5.0 The Practice of Microinsurance in the Philippines

5.1 MFIs Studied

Three types of microfinance institutions were studied: co-operative MFIs, NGO MFIs, and MFI-owned insurance companies. The *co-operative MFIs* were represented by the Sta. Ana Multi-purpose Co-operative (SAMULCO), the Paco-Soriano-Pandacan Development Co-operative (Paco Soriano PDC), and the Cebu People's Multipurpose Co-operative (Cebu People's MPC). The three *NGO MFIs* in this study were the Center for Agricultural and Rural Development (CARD), ABS-CBN Bayan-Microfinance (Bayan) and Alalay sa Kaunlaran sa Gitanang Luzon, Inc. (ASKI). CLIMBS and CISP, representing the *MFI-owned insurance companies*, were introduced in the previous section.

Information was gathered through key informant interviews, focus group discussions, and a review of secondary information.

5.1.1 Sta. Ana Multi-purpose Co-operative (SAMULCO)

SAMULCO, one of the oldest and biggest co-operatives in the Philippines, began operating in 1967 and has over 12,000 members. Based in Davao City in the southern part of the Philippines, SAMULCO caters to a diverse set of clients ranging from farmers, government employees, fishermen, students, and micro and small entrepreneurs. As of December 2000, it had an asset base of P202,886,983 (USD 4,057,740) with loans granted amounting to P176,003,280 (USD 3,520,066) corresponding to a total number of 12, 411 loans granted for that year. Since 1983, the co-operative has covered all loans with credit-life protection offered through CLIMBS and CISP.

5.1.2 Paco-Soriano-Pandacan Development Co-operative (Paco Soriano PDC)

Started in 1997, Paco Soriano PDC serves mostly vendors in three public markets in the City of Manila. It had 2,500 members and assets of P103,132,332 (USD 2,062,647) as of December 2000.

5.1.3 Cebu People's Multipurpose Co-operative (Cebu People's MPC)

Cebu People's MP) is one of the biggest co-operatives in the province of Cebu. Cebu People's MPC had a total number of 16,475 members, 6,845 of whom were regular members with fixed deposits while the remaining 9,630 were associate members who had savings and/or time deposits with the co-op. As of the year 2000, the co-op had assets of P88,212,789 (USD 1,764,256).

These three co-operatives—SAMULCO, Paco Soriano PDC, and Cebu People's MPC—are members of the National Confederation of Co-operatives (NATCCO), the largest confederation of co-operatives in the Philippines.

5.1.4 Center for Agricultural and Rural Development (CARD)

The CARD group is composed of three distinct organisations:

- CARD, Inc. or CARD-NGO;
- CARD Bank; and
- CARD-Mutual Benefit Association (MBA).

CARD-NGO started in 1988 as a non-profit organisation engaged in providing livelihood projects to landless rural coconut farmers and rural organisations in the province of Laguna. In the early 90's CARD-NGO gradually shifted to savings and lending operations

directed solely at women. In 1994, the Members Mutual Fund (MMF) was started for the primary purpose of protecting the loans upon the death of a member. On September 9, 1999, the management of the MMF was formally turned over to the members. The MMF was spun-off as CARD-Mutual Benefit Association (CARD-MBA) and on May 22, 2001, CARD-MBA received its license to operate as a Mutual Benefit Association from the Insurance Commission.

CARD-MBA is a mutual benefit association formed to promote the welfare of marginalised women. It extends financial assistance to its members in the form of death benefits, medical subsidy, pension, and loan redemption assistance. As of April 30, 2001, CARD-MBA had 39,793 active members in its 28 branches located in Laguna, Masbate, Marinduque, Mindoro, and Quezon provinces.

The third entity in the CARD group is CARD Bank. Savings and lending operations of the CARD-NGO were spun-off as CARD Bank in September 1997. CARD Bank was the first Philippine NGO to transform into a bank and is currently considered the largest MFI in the country. With microfinance operations now housed in CARD Bank, CARD-NGO focuses solely on training operations. All three CARD entities currently have the same board chairman.

5.1.5 ABS-CBN Bayan Microfinance

ABS-CBN Bayan Microfinance utilises the Grameen Bank approach with modifications picked up from other existing Philippine MFIs. Established in 1997 by the ABS-CBN Foundation with a microcredit project for 25 poor women in Quezon City, it uses the concept of the multi-window branch in which one branch handles many different loan products. Today, it has five regional offices with a total of 20 branches. All branches are in Luzon with the exception of Iloilo, which is in the Visayas. Its assets reached P81,070,845 (USD 1,621,417) in December 1999, and amount of loans disbursed for that year was P127M (USD 2.54M).

5.1.6 Alalay sa Kaunlaran sa Gitnang Luzon, Inc. (ASKI)

The Alalay sa Kaunlaran sa Gitnang Luzon, Inc. (ASKI) is a non-stock, non-profit organisation whose main objective is to promote and develop microenterprise and social services. It started its operations in 1987. To date, ASKI has disbursed loans amounting to P346,498,821 (USD 6,929,976) to 218,722 beneficiaries. As of June 2000 the organisation's asset base was P 39,332,951 (USD 786,659).

5.2 Microinsurance Products

The MFIs offered from one to three microinsurance products (see Table 5-1). Life insurance was particularly common among co-operatives, while credit life insurance was common in both the co-operatives and the NGO-MFIs. Health insurance was also provided by the three co-operatives, while the NGO-MFIs had plans to provide health insurance.

Table 5-1. Summary of Insurance Products by Organisation

Cases	Year founded	Type of Organisation	Type of Microinsurance Coverage		
			Credit-life	Health	Life
CLIMBS	1977	MFI-owned insurance company	Insurer		Insurer
CISP		MFI-owned insurance company			Insurer
CARD	1988	NGO	Group self-insurance	Currently None, planned group self-insurance by 2002	Group self-insurance
Bayan	1997	NGO	Group self-insurance	Third Party Insurer	None
ASKI	1987	NGO	Group self-insurance	None	Group self-insurance
SAMULCO	1967	Co-operative	Third Party Insurer	Group self-insurance	Group self-insurance and Third Party Insurer
Paco Soriano PDC	1977	Co-operative	Group self-insurance	Group self-insurance	Group self-insurance
Cebu People's MPC	1972	Co-operative	Third party	Group self-insurance	Group self-insurance

5.2.1 Credit-life Insurance

Credit-life or loan insurance is imposed on borrowers in order to buffer the MFI from loss in the event of the death of the borrower. This safeguarding mechanism insures the loan portfolio and improves the financial viability of the MFI. All MFIs with credit-life insurance programs had a similar approach. First, the credit-life cover was compulsory. The schemes were designed such that premiums were automatically deducted from the loan and/or added to their amortisation payments. Second, there were no exclusions; all loans were covered under

the credit-life insurance.

Two of the five MFIs studied, namely Cebu People's MPC and SAMULCO, offer credit-life cover through CLIMBS under its Co-op Loan Protection Plan (CLPP). The co-ops act as CLIMBS' agents and receive 20 to 25% commission from the premiums collected. The NGO-MFIs and Paco Soriano PDC, on the other hand, self-insure their loan portfolios against the risk of borrower death.

The management of SAMULCO and Cebu People's MPC felt it was administratively easier to insure their members under CLIMBS. Minimal administrative cost was incurred and the co-operatives earned commissions. More importantly, the co-op did not have to bear the risks of the insurer.

Bayan preferred to have control over the premiums, policies and avoid transaction costs with commercial insurance companies. ASKI started systematising its Mutual Aid Fund in 1999. The Mutual Aid Fund program is still in its formative stage and ASKI preferred to control and closely monitor the program on its own.

Table 5-2. Summary of Credit-Life Insurance Products by Organisation

MFIs	Name of Credit Life Insurance	Risk Management Method	Premium for a P5,000-loan payable in 2 months
CARD	Loan Redemption Fund	Self-insurer	P125 (USD 2.5)
Bayan	Damayan Fund	Self-insurer	P150 (USD 3)
ASKI	Damayan Fund	Self-insurer	P300 (USD 6)
SAMULCO	Loan Protection Plan	Third Party (CLIMBS)	P37.5 (USD .75)
PACO SORIANO PDC	Loan Guarantee Fund	Self-insurer	P6 (USD .12)
CEBU PEOPLE'S MPC	Loan Protection Plan	Third Party (CLIMBS)	P37.5 (USD .75)

Premium Setting. Through their relationship with CLIMBS, Cebu People's MPC and

SAMULCO had access to an actuary who set premiums, as mandated by the Insurance Commission.

CARD-MBA also made use of an actuary in setting its premiums, benefits and policies. The rest of the MFIs did not have any actuarial basis for computing their premiums. On the part of ASKI, for example, the P300 premium, the Mutual Aid Fund (MAF) collected from their clients was seen as the most affordable amount their members can give and the most reasonable fee to make the fund operational, in terms of being able to pay the claims at a given time. The contributions were computed intuitively. Table 5-3 summarises the premium collection methods and premium rate of the four MFIs that provide credit life insurance on their own.

Table 5-3. Premium Collection Methods for Credit Life Insurance

Institutions with In--house Credit Life scheme	Credit Life Insurance Premium	Premium Collection method	
ABS-CBN Bayan Microfinance	5% of total loan	Automatic deduction from the principal	5% premium breakdown - 2% service fee, 2.7% initial savings fund and 0.3% damayan or credit-life premium
ASKI	P300.00 (USD 6)	Automatic deduction from the principal	The premium goes to credit and life insurance scheme
CARD-MBA	2.5% of loans P10,000 (USD 200) above	Automatic deduction from the principal	
Paco Soriano PDC	depends on the borrower's loan amount, fixed deposit and loan term	Automatic deduction from the principal	

Overall Performance. In the MFIs studied, credit-life insurance was integrated into the other operations such that direct administrative costs could not be isolated and quantified. For Paco Soriano PDC, the administrative costs were charged against the general administrative budget rather than against the premium income. This was a deliberate subsidy to the insurance

programs and explained as the co-operative's social responsibility to its members.

CARD-MBA estimates that it does not use more than 20% of total collections the administrative, maintenance and operating expenses.

For all of the organisations for which there was sufficient data, claims were significantly lower than premiums, as shown in Table 5-4.

Table 5-4. Proportion of Claims Paid and Premiums Collected of MFIs

MFIs	Claims paid	Premiums collected	Proportion of claims paid to premiums collected
ASKI	P227 400 (USD 4548)	P683, 800 (USD 13, 676)	0.33
CARD	P1,804,142 (USD 36, 082)	P5,529,417 (USD 110, 588)	0.33
CEBU PEOPLE'S MPC	P642,085 (USD 12, 841)	P2,193,779 (USD 43, 875)	0 .29
PACO SORIANO PDC	P361,500 (USD 7,230)	P479,940 (USD 9,598)	0.75
SAMULCO	P3,139,350 (USD 62,787)	---	---

--- not available

Dealing with Adverse Selection. CLIMBS' Co-op Loan Protection Plan (CLPP) excludes co-op members who are 65 years old and above from loan coverage. Coverage is automatically terminated on the borrower's 65th birthday, regardless of the outstanding indebtedness. Only members who are in good health and are able to perform their social and economic duties can be covered. Around their 65th birthday members are required to submit a health certificate declaring that they are in good health and able to perform normal activities.

SAMULCO requires members to submit a health certificate before borrowing more than P20,000.00 (USD 400) to assess the health of the member and his/her capacity to repay the loan. Another risk management mechanism used by the co-op was through waiting periods, where the granting loans was based on the member's length of membership. For example,

members who have been with the co-operative for less than six months could only apply for loans that were less than 150% of their share capital, while those who have been a member for over three years could borrow a loan amount up to 250% of their share capital. These policies were implemented after a person joined the life insurance program of the co-op and then passed away five months later with a claims exceeding P100,000 (USD 2,000).

Dealing with Fraudulent Claims. In general, by ensuring a strong sense of ownership of the organisation among members, the problems of asymmetric information and the related risks of adverse selection and moral hazard were reduced. The use of clear operational policies ensured that claims were to be verified by supporting documentation such as death and medical certificates. In Paco Soriano PDC, it was customary for co-op managers and board members to go to the wake of departed members. This allowed them to validate claims, though this was not the primary motive for going to the wake.

Incidence of fraud in the provision of microinsurance was very rare in SAMULCO. According to General Manger Daniel Corral, there was one example of a member who lied in his health certificate when he applied for a loan. He had a terminal illness when he enrolled in SAMULCO's credit-life scheme. After this member's death, his sister insisted that the co-operative cover her brother's outstanding loans. The co-operative did not write-off the member's loan, as it was able to prove that he was aware that he was terminally ill when he acquired the policy and failed to disclose this.

5.2.2 Life Insurance

Besides credit-life, several of the MFIs studied also offered life insurance policies to the their members, as summarised in Table 5-5. Life insurance benefits were given upon the death of a member who paid a certain premium for a particular period of time. Benefits were given directly in cash to the member's beneficiaries.

Table 5-5. Summary of Life Insurance Products by Organisation

MFIs offering Life Insurance	Life Insurance Project	Type of Risk Management	Premium Collection Method
CARD-MBA		Group self-insurance	Through the cell leader, cell leader then deposit collection to CARD account
ASKI	Mortuary Assistance Fund	Group self-insurance	Over-the-counter payment
CEBU PEOPLE'S MPC	Social Services Package (Mortuary and Health Insurance)	Group self-insurance	Automatic deductions from dividend share Over-the-counter payment
PACO SORIANO PDC	Damayan I	Group self-insurance	Automatic deductions from dividend share Over-the-counter payment
	Damayan II	Group self-insurance	Automatic deductions from dividend share
SAMULCO	Mortuary Aid and Trust Fund (MATF)	Group self-insurance	Automatic deductions from dividend share Over-the-counter payment
	SAMULCO Mutual Benefits System (SMBS)	Group self-insurance	Over-the-counter payment
	Member's Yearly Renewable Accident-C- Life (MYRACL) Plan	Insurance Agent	Over-the-counter payment

Paco Soriano PDC, SAMULCO, and Cebu People's MPC all had long-running life insurance schemes based on the traditional *damayan* system that were systematised and institutionalised two or three years after the co-operatives were founded. Whenever a Paco Soriano PDC member passed away, a P5 (USD 0.1) contribution was collected from the other members. The collected money was then given to the family of the dead member. In SAMULCO, the co-operative deducted ten pesos (USD 0.2) from each member's savings account and the collected money was also given to the family.

CARD-NGO started offering life insurance policies, called the Members' Mutual Fund (MMF) to its clients in 1994. This was created together with the credit-life insurance project and aimed to cover burial expenses in cases of death among the members or their legal spouses or children.

The Mortuary Assistance Fund (MAF) of ASKI started with members paying P50 (USD 1) with the benefits pegged at P5,000 (USD 100) to P10,000 (USD 200). A mechanism was eventually developed in which members would pay P300 before the release of a loan. This would need to be replenished before another loan could be released. The amount of cash benefits depended on the total number of clients that contributed to the mortuary fund for a specific period.

The lack of actuarial computation to set premiums was common among the co-operatives. Pricing and benefits were computed based on what the institutions' officers thought was reasonable for both the institution and the members. Because of a relatively long relationship with their clients, the institutions used their judgment to assess members' capacity and willingness to pay.

It was also discovered that these institutions were not very strict with the claims requirements and with the implementation of their insurance rules. There were instances when the co-operatives bent rules to accommodate members in need. In SAMULCO, for example, one policy to qualify for claims was to maintain a savings account of at least P500.00 (USD 10) and to have regularly replenished their mortuary fund. Although an instance was reported in which a member died with only P2.50 (USD 0.05) in his savings account and nothing left in his mortuary fund, the co-operative's management decided to give a payout to the beneficiary knowing that this member's family needed the money. A similar event happened in Paco Soriano PDC.

Life insurance products offered by these institutions were mostly compulsory. In co-operatives, they offered first level, compulsory packages at a low price. Additional insurance coverage was optional. For example, in Cebu People's MPC the members were required to

avail of the Social Package 1 with a P100-premium (USD 2) and P10,000-mortuary benefits (USD 200). Packages 2 to 5 were optional and offered to members who can afford them and who were looking for more coverage. The co-operatives found it easy to implement or enforce compulsory life insurance because the practice of *damayan* was deeply ingrained among their members.

Eligibility. There were some important differences in the eligibility of the life insurance schemes. CARD-MBA and ASKI serve primarily poor, rural women. The life insurance schemes of these NGOs covered the member, her legal spouse and children, a design that seems to reflect the preference of women to include their family members in the benefits.

Co-operatives did not show such an inclination. The spouse and dependents were generally not covered. In 1995, SAMULCO established the SMBS to extend coverage to the members' spouses and dependents. In contrast, Paco Soriano PDC and Cebu People's MPC have no plans to include the members' dependents in the coverage.

To access insurance from the NGO-MFIs, policyholders had to be active borrowers. Eligibility for the co-op's scheme, however, only required that one was a member regardless of one's participation in the co-operative's credit services. They only needed to contribute a certain amount to the Mortuary Fund and replenish this monthly. The amount to be replenished depended on the number of mortalities for a specific period. In this scheme, risk was borne by the members and not by the MFI.

Since most people prefer not to remain in perpetual debt, the co-op's approach provides greater continuity of coverage than the NGO-MFIs.

Benefit Packages. Several institutions offered a range of benefit packages: Cebu People's MPC provided five options, SAMULCO three, and Paco Soriano PDC two. In contrast, the NGOs offered only one package. This difference may reflect the fact that the co-operatives have a heterogeneous clientele with different needs and paying capacities. The co-operatives thus created packages with some level of differentiation to address different market

segments. ASKI and CARD-MBA have more homogenous clients (poor rural women), thus one insurance product was more appropriate.

CLIMBS' insurance products may provide better coverage because both the Mutual Assistance System and the MYRACL—which were offered by Paco Soriano PDC and SAMULCO respectively—had added features not found in the insurance products of other MFIs, including doubling the benefits when death was caused by accident and provided indemnity for loss of limbs.

Premium Collection. Premium collection methods differed among the institutions studied. In CARD-MBA, the centre leader collected weekly premiums from each member during the loan repayment process. She then either brought the collection to a CARD Bank branch or deposited funds in the CARD account in a designated bank in the area. For the co-operatives, the premium was either automatically deducted from the members' dividend share or patronage refund at the start of the year, or collected through the members' cash payment in instalments or in on lump sum, depending on the members' capacity to pay. There were no means to determine if the two premium collection methods differ in transaction costs. Both were essentially integrated into existing collection mechanisms.

Payment Schemes. Building on the history of *damayan*, some of the products do not require upfront premiums, but rather request contributions when insured events occur. Just-in-time payment was done by making fixed deductions from the accounts of the members every time a member died. This system was practised by Paco Soriano PDC, ASKI and SAMULCO. Members could claim benefits as long as they regularly replenished their funds. In SAMULCO's Mortuary Aid and Trust Fund, members contributed P10 (USD 0.20) per mortality and contributions were deducted every month. In Paco Soriano PDC, the same procedure was used, the only difference was that the members had to replenish the fund annually and the contribution of P50 (USD 1) was made per mortality.

This type of arrangement essentially eliminates the need for actuarial analysis since deductions occur after deaths occur. Participants in a just-in-time payment scheme do not

know, however, how much it will cost them in a given year. In addition, such schemes do not have reserves or reinsurance to cope with covariant risks.

Claims Processing. Claims processing was strictly followed in NGO-MFIs' life insurance projects. In CARD-MBA, the beneficiary had to submit claim forms along with certified copies of the following: death or disability certificate, plus a marriage contract for the death of the spouse, or a birth certificate for legitimate children. The Board of Advisors (BOA) then determined whether the claimant would be compensated or not.

Premium Setting. Life insurance had been a long-running program implemented by the MFIs. What started as the indigenous *damayan* aid given to co-members had evolved to a more organised and systematic insurance among the co-operatives. Premium contributions were arrived at not through actuarial computations, but charging what was considered to be the reasonable price based on the members' capacity to pay.

Risk Management. These life insurance products were mostly self-managed, although the co-operatives offered additional insurance packages from CLIMBS. The self-insured schemes were particularly lax in their methods of managing risks of fraud, adverse selection and moral hazard.

In Paco Soriano PDC, the requirement of showing a death certificate to avail a death benefit was not being strictly implemented. Funds were disbursed based on a verbal report of a member's death, which was later confirmed during the co-operative management's visit to the member's wake.

MFIs gave their members grace periods during which they could replenish their mortuary fund. Beyond this time, members were considered ineligible for any claims. The MFIs' grace period for their life insurance was usually 30 days, after which time members were given letters reminding them to replenish their fund.

The co-operatives had only recently incorporated waiting periods the insurance

schemes. In 2001, SAMULCO implemented a waiting period policy because of an incident where a new member, whom was terminally ill, enrolled in the co-operative's life insurance scheme and died three months later. The institution was not aware of the member's medical condition when he applied. In addition to establishing a waiting period as a control against adverse selection., the co-operative required the new applicants to undergo a health examination or present a health certificate. The co-operative also created a benefit schedule whereby better benefits were available to long-standing members.

5.2.3 Health Insurance

Two of the MFIs studied provided health insurance: Paco Soriano PDC and Cebu People's MPC. Information on SAMULCO's health insurance scheme is also included here, although this scheme was only available to employees and officers and will be offered to members in 2002.

None of the NGO-MFIs in this study had health insurance schemes at the time of writing. They have, however, recognised the health needs of their members and had plans of offering health insurance to their clients. CARD-MBA intends to put up its own health insurance package, while ABS-CBN Bayan Microfinance is partnering up with PhilamCare, a for-profit HMO in 2002.

Cebu People's MPC. Health insurance had been a part of Cebu People's MPC since 1972. It started separately from the mortuary program, but the two insurance schemes later evolved into one comprehensive insurance package, the Social Service Package, which was formally launched in 2000. There were five health and death aid packages that the members could choose from. Once launched, the members decided, through a General Assembly (GA), that Package 1 should be made compulsory. The same GA decision mandated that premiums be automatically deducted from each member's dividends for the year, amounting to P520 (USD 10.40) per member. Members whose dividends did not reach the specified amount, would pay the compulsory premium for the mortuary assistance amounting to P100 (USD 2) in cash.

Benefits under the Social Service Package include free medical consultation, medicine refund, dental and optical services. Death benefits vary across the five packages—the minimum benefit is P10,000 (USD 200). The benefit packages were modelled from the Angono Credit and Development Co-operative (ACDECO), another affiliate co-operative of NATCCO that integrated the two insurance products.

Table 5-6. Summary of Health Insurance Packages offered by MFIs

	CEBU PEOPLE'S MPC					PACO SORIANO PDC	SAMULCO
	Package 1	Package 2	Package 3	Package 4	Package 5	Hospitalisation Aid	SAMULCO Care
Premium	USD 10.4	USD 12.8	USD 15.20	USD 17.6	USD 20	USD 2	USD 24
Benefits	Basic benefit package* plus USD 20 for reimburse-ment of medicines during confinements	Basic benefit package* plus USD 40 for reimbursement of medicines during confinements	Basic benefit package* plus USD 60 for reimbursement of medicines during confinements	Basic benefit package* plus USD 80 for reimbursement of medicines during confinements	Basic benefit package* plus USD 100 for reimbursement of medicines during confinements	USD 50 for hospitalisation expenses and USD 10 for reimbursement of medicines during confinements	USD 1500 for hospitalisation expenses, discounts on outpatient services.
Type of Risk management mechanism	Group self-insurance	Group self-insurance	Group self-insurance	Group self-insurance	Group self-insurance	Group self-insurance	Group self-insurance

*Basic benefit package includes free medical consultation for the member and his/her dependents, free optical consultation and free eyeglasses, unlimited tooth extraction and temporary filling, once a year cleaning and permanent filling, 20% discount for other services including beneficiaries.

Paco Soriano PDC. The health insurance scheme of Paco Soriano PDC was added to the Mortuary Program and was collectively labelled the *Damayan* Fund in 1989. The P2,500 (USD50) benefit was initially conceived to help the sick members to be admitted in hospitals by giving them money for a down payment. However, administrative complications in providing upfront payments eventually resulted in a conversion to a reimbursement scheme for hospitalisation expenses.

Table 5-7. Paco Soriano PDC's Health Insurance Programs from 1974-2001

Insurance Program	Year Implemented	Premium Contribution	Benefits	Premium Collection Method
Mortuary Program	1974 – 1989	USD 4	Death aid	Automatic deductions from dividend share
Damayan Fund	1989 – 2001	USD 6	Death aid of P10,000 (USD 200) and hospitalisation aid which includes a maximum of P2,500 (USD 50) for in-patient services and another P500 (USD10) for reimbursement of medicines	Automatic deductions from dividend share Over-the-counter payment if member's dividend share did not reach USD 6

SAMULCO. SAMULCO's health insurance scheme is slightly different from the other co-operatives offering health microinsurance. The program started in 1992 under the Medical Mission Group Hospital Co-operative (MMG) of Davao City. MMG acted as the health service provider and insurer. In 1998, SAMULCO tapped the services of Ayala Care, a private commercial insurance company, as health insurer for its officers and employees. By adopting the Ayala Care packages, the co-op established "SAMULCO Care" in 1999. The health insurance will be offered to the members on 2002.

Claims Processing. All three co-operatives reimburse expenses based on the provision of appropriate documentation. In Cebu People's MPC, a member seeking treatment or medication presents himself or herself to the physician hired by the co-operative to access free

outpatient services. For pharmaceutical benefits, the co-operative reimbursed the cost of medicines prescribed by the co-op's physician after members submit prescriptions and official receipts. For Paco Soriano PDC and SAMULCO, members who required inpatient services and purchased medicines while they were in hospital had to present a statement of account from the hospital and the receipts for the medicines. The co-op Treasurer or officer-in-charge of insurance verified the authenticity of the documents and then reimbursed the member's hospital expenses.

Coverage. Between Cebu People's MPC and Paco Soriano PDC's health insurance programs, variation lay in the individuals covered under the health insurance project. In Cebu People's MPC, members and their immediate dependents are covered while in Paco Soriano PDC, only co-op members are allowed to enrol.

By placing a ceiling on the total potential benefit in any one year, the schemes are able to reduce the risk of over usage, contain costs and make reliable projections. The level of coverage, however, differs between the three programs. Cebu People's MPC reimburses outpatient-service expenses only, while Paco Soriano PDC pays for in-patient services availed by the members. SAMULCO, on the other hand, pays for the hospitalisation expenses and gives a discount on outpatient services.

Premium Setting. The co-operatives did not use a technical or actuarial basis for setting premiums for their health insurance programs. The premium amounts were based on what members had previously paid for medical and death benefits prior to the consolidation of the two programs. Even if the process was unscientific and imprecise, the amounts were computed to include costs associated with providing insurance services, including administrative costs and claims expenses. Cebu People's MPC for instance pays retainer's fees to the co-op physician at P12,000 (USD 240) every month. They had allotted P70 (USD 1.40) per member for dental expenses and P450 (USD 9) for every pair of eyeglasses in a given year.

For Paco Soriano PDC, in 1989 the General Assembly approved the addition of P100 (USD 2) to the previous P200 (USD 4) life insurance premium to be able to give additional

P2,000 (USD 400) hospitalisation benefits to the members.

The co-operatives were generally attuned and responsive to their members' needs. To provide and sustain health insurance, they considered the paying capacity of their members. The co-operatives were also quick to point out that insurance was a social service that they offered to their members, not an income-generating mechanism.

Premium Collection. The health insurance schemes operated by Cebu People's MPC and Paco Soriano PDC had similar methods of administration and premium collection. Both insurance services were compulsory (at least the Package 1 for Cebu People's MPC) and premiums were automatically deducted annually from the members' dividend share or patronage refund. For SAMULCO Care, the premium for the co-op employees and officers were deducted from the Co-operative's Provident Fund. Employees and officers who wished to enrol their spouses or dependents into the insurance scheme paid for them separately. Besides minimising the transaction costs associated with premium collection, automatic deductions also serve to prevent lapsed coverage that can occur with over-the-counter payments.

Adverse Selection and Exclusions. The MFIs used several mechanisms to control adverse selection. First, those 65 years old and above and those with terminal cancer were excluded from the health insurance project. In the case of Paco Soriano PDC, only co-op members could enrol, while in SAMULCO only employees and officers were covered by the SAMULCO Care project. Pre-existing illnesses were excluded for coverage in the first year of membership in the program.

Risk Management. The co-operatives employed formal procedural guidelines and policies concerning the operation of the health insurance program to prevent fraud. Documents such as receipts and prescriptions must be submitted, processed, and approved by appropriate officers of the organisation before claims were made.

However, the Paco Soriano PDC General Manager revealed that in instances when they had discovered fraud, it was the co-operative officers and employees who were involved.

The GM said that it was very unlikely that members commit fraud because they were not aware of the policies and thus did not know potential loopholes.

Although Paco Soriano PDC had been collecting a compulsory fee from its members since 1989, officers admitted that information about the health insurance program had not been disseminated. Only the officers, employees, and a few members knew of the program and were able to avail of the benefits. The officers' withholding of information resulted in an inequitable situation. In effect, the majority of members who paid but were not aware of the health benefits subsidised the few individuals, mostly officers, who were aware of the scheme. Withholding this information from members was done for fear that funds could be depleted if all members made claims, which stemmed from the organisation's lack of confidence in the soundness of their package designs.

5.3 Analysis by Institution Type

Three types of organisations were scrutinised in this study: formal MFI-owned insurance corporations, NGO-MFIs and co-operative MFIs. This section analyses institutional type as it influences the operation and provision of microinsurance. It specifically looks into how the inherent nature of each type of organisation affects their relative strengths as insurance providers. Table 5-8 summarises the strengths and weaknesses of each organisational type.

Table 5-8. Strengths and Weaknesses by Type of Organisation

Organisation	Strength	Weakness	Ways of Overcoming Weaknesses
MFI-owned Insurance Company	Technical skills in insurance Large financial base Professional managers Low priced insurance compared to for-profit policies Simpler than group self-insurance	More expensive compared to group self-insurance Relative administrative inefficiency Weak patronage of co-operatives	Focus on products that are difficult for co-operatives to self-insure Increase operational efficiency though closer links with co-operatives
NGO-MFI	Focus results in prudent risk management Professional managers	Lack of innovation Limited services	Pool resources for R&D in microinsurance
Co-operative-MFI	Social capital Risk-bearing member-ship allows ventures into health insurance innovation	Risky insurance design	Access technical assistance in insurance design Pool resources for R&D

5.3.1 MFI-owned Insurance Companies

CLIMBS and CISP are for-profit corporations owned by microfinance institutions and licensed by the Insurance Commission. Their primary motive was to provide low cost insurance for the informal sector. These insurance companies intend to make profits, which will enable them to sustain their efforts and expand in their coverage. No subsidies were built into the insurance products. They had professional managers and actuaries. As regulated insurers, they had to comply with financial and actuarial standards for prudent risk management and sound financial management.

Insurance policies designed for the informal sector addressed a demand that other for-profit insurance companies did not supply, providing much needed risk management instruments for the informal sector.

For their MFI-owners, purchasing insurance from these firms was much simpler and less risky than managing the insurance scheme themselves. Yet less than 10% of the co-operative members in the network of CLIMBS patronised it. Many co-operative managers believed that CLIMBS' policies were inferior to the insurance products that co-operatives could design on a group self-insurance basis. Administratively, CLIMBS and CISP were said to be slower, more expensive, and less sensitive to local realities than the insurance products offered through self-insurance.

These weaknesses may be overcome through closer integration with the co-operatives so that administration is less centralised. Focusing on specific products that are difficult to provide through self-insurance will also keep MFI-owned insurance firms competitive.

Unknowingly, CLIMBS and CISP became sources of the insurance technology that the co-operatives adopted or copied as they designed their own schemes. Given the tendency of co-operatives to manage insurance on their own, this demand for insurance skills among co-operatives may be a market opportunity that CLIMBS and CISP might consider addressing.

5.3.2 NGO-MFIs

The NGO-MFIs are non–stock, non–profit organisations governed by trustees elected in a general assembly. In the case of CARD, the governance structure was more like a co-operative, since most trustees came from the member–borrowers.

While all of the co-operative MFIs had ventured into the provision of health insurance, none of the NGO MFIs have. This may be explained in two ways. First, NGO-MFIs were highly focused on microfinance operations. Although life insurance, particularly credit-life, is as a

logical extension of the savings and credit services, health insurance was beyond the NGO's core competencies.

The second explanation has to do with the ownership structure. Because members do not own the NGO-MFIs, managers are risk-averse, unwilling to venture into high-risk insurance products since they could not share the business risks with their clients. This conservative approach is also reflected in the operations. Although premiums and benefits were not (usually) based on actuarial studies, product design involved conservative forecasts of claims plus administrative costs. Since they lacked in-house technical capacity, managers basically adopted an insurance product from a formal insurance firm and then made some modifications.

The motive for getting into microinsurance was primarily to manage the risks of their microfinance operations, and only secondarily as a social service to their members. An additional motivation was to generate an extra source of funds, which could be on lent and generate interest income.

CARD's approach toward microinsurance may represent a possible solution to the inherent weaknesses of NGO-insurance providers. The organisation has set up a completely separate organisation, an MBA, with member-owners. Not only does this structure foster a sense of ownership that allows for risk sharing, but also it separates insurance risk from credit risk.

5.3.3 Co-operative MFIs

Co-operatives have a long history of striving to address their members' diverse needs, which partly explains their multi-faceted approach to insurance provision. The ownership structure has also enabled co-operatives to take greater risks than the NGO-MFIs. Co-operatives are owned by their members, who meet once a year to elect a board of directors from among themselves. As owners, the members share in the profits as well as in the risks. For

example, though health microinsurance is extremely risky—especially since co-operatives do not have the expertise to manage such projects—managers knew that members accepted the risks facing the co-operative enterprise.

The members' sense of ownership also reduces the need for marketing expenses because microinsurance products created by co-operative management were readily supported by the membership. Furthermore, the co-operatives' diverse operations and enterprising character created an environment supportive of innovation.

The motive for entering into microinsurance was primarily as a social service to co-operative members. Some co-ops even subsidise the administrative costs of insurance because it was a social protection product. Only secondarily did insurance serve as a risk management tool for the co-operative's operations.

The provision of insurance also allows the co-operatives to gain institutional capital through increased support from their member-owners. Insurance enabled the co-ops to leverage social capital, as people supported each other from one adversity to the next. Risk sharing reinforced the sense of solidarity and social responsibility among members. There were also political gains because the annual general assemblies of co-operatives were political exercises and good performance of the co-operative—in terms of valued services more than financial performance—benefited the incumbent leadership.

The co-operatives' weaknesses include the technical aspects of insurance, such as product design, pricing and risk management. Indeed, the co-ops' innovativeness is a cause for concern since design flaws are likely to occur as managers experiment with their own insurance schemes. This disadvantage could be overcome by accessing technical assistance from CLIMBS and CISP of which they were members.

Table 5-9. Profile of the Different Institutions

	Informal		Formal	
Type of Micro insurer	Co-op MFI	NGO MFI	MFI-owned insurer	For-profit insurance
Legal personality	co-operative	Non-stock, non-profit	For-profit corporation	
Leverage	Low	Low	High	High
Basis of coverage and premium	forecasted claims plus admin costs divided by no. of members Some actuarial optimum when reverse engineered from formal insurance products	forecasted claims plus admin costs divided by no. of members Some actuarial optimum when reverse engineered from formal insurance products	Statistical maximum less profit less loading costs	Statistical maximum less profit less loading costs
Ownership of savings/profits/losses	Co-operative or members	MFI	Investors	Investors
Motive	Primarily Social protection/ social service Risk management for MFI	Primarily Risk management for MFI Social protection/social service	Provide low-cost insurance for the informal sector, Profitability	Profitability
Subsidies	Source or recipient of subsidies Across risk groups and financial subsidies	Source or recipient of subsidies Across risk groups and financial subsidies	None	None
Resources	Financial plus social capital	Financial	Predominantly financial	Predominantly financial
Additional gains from the microinsurance	Political capital Social capital Institutional capital Synergy Interest income	Institutional capital Social capital Synergy Interest income		

6.0 Risk Profile and Coping Strategies of MSEs

In the Philippines, micro and small enterprises (MSEs) are defined as any business activities with total assets falling below P15,000,000 (USD 300,000) including loans but excluding the land where the business' office was situated. In terms of employment, those enterprises with 9 employees or less were considered micro, while those with 10-99 employees were considered small enterprises. Micro and small enterprises were mostly household enterprises. Table 6-1 shows the categories of enterprises based on asset and employment.

Table 6-1. Enterprise Category by Asset and Employment

Size	Assets	Employees
Micro	less than-P1,500,001	1-9
Small	P1,500,001- P15,000,000	10-99
Medium	P15,000,001-P60,000,000	100-199

Source: Philippine Law, Statutes and Codes. www.chanrobles.com. Republic Act 6977 of 1997

This section aims to describe the risk profile of micro and small enterprises in the Philippines based on a survey of 294 MSE operators in different parts of the country. Respondents were all members or clients of the 6 MFIs. This section begins by describing the MSE respondents and their perception of risks. It then considers their coping mechanisms, including a detailed analysis of their use of savings and insurance as risk-managing financial services.

6.1 Profile of MSEs in the Sample

The respondents were mostly women as shown in Table 6-2. This was due to the

NGO-MFIs' exclusively female membership. It is interesting to note, that the co-operatives also had mostly women members. The mean age of respondents was 41.7 for women and 43.6 for men. They have been in business for an average of 9.2 years and they work long weeks, as shown in Table 6-3.

Table 6-2. Gender Composition of the MSE Sample

Type of MFI	Female (%)	Male (%)
NGO-MFIs	100	0
Co-op-MFIs	68.5	24.7

Table 6-3. Time at Work

Item	Mean
Years in business	9.2
Number of days per week	6.2
Number of hours per day	9.4

One quarter of the respondents had never borrowed money. As revealed in Table 6-4, almost 32% said they had one loan. Fourteen percent said that they had a second loan and almost seven percent said they had at least three loans.

Table 6-4. Number of Loans

Number	%	Rank
None	24.8	2
One	31.6	1
None	21.8	3
Two	15.0	4
Three or more	6.8	5

Their main business assets were weighing scales, vehicles and stock; cash in the bank and cash on hand. Average business assets were USD 3,342, indicating that most respondents operated microenterprises.

Table 6-5. Cost of Assets in US Dollars

Asset	Min	Max	Mean
Vehicle	140	7,000	2,684
Inventory of goods	40	4,000	395
Others	0.4	1,200	162
Cash on Hand	1	400	45
Cash in Bank	60	4,000	28
Weighing Scale	40	200	27
Total	281	6,800	3,342

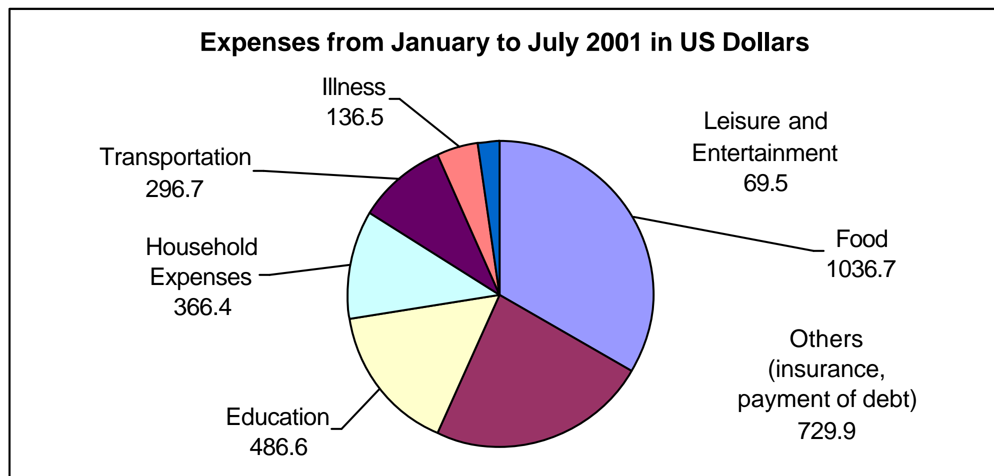
Respondents were predominantly involved in commerce and production. Commerce refers to the diverse economic activities ranging from trading of fruits and vegetables on the streets to retailing of chicken and other meat products in public market stalls. Production is primarily home-based, including food preparation, and making rags, necklaces and home decorations.

Respondents were asked about their expenses for the last 7 months from January to July 2001. As shown in Figure 6-1, they spent most on food and education. Interestingly, the second largest expense, after food, was for other reasons, which include the payment of insurance and debts. Since the respondents were members of MFIs, payments of debts were high. Payment of insurance premium may comprise only 2 to 3% of the other payments the respondents had to settle.

High education expenses may be due to high dependency ratio (the ratio of non-working dependents to working individuals in the household) in Filipino households. This means that there is a relatively large proportion of the population under the age of 15 and above the age of 65 who were economically dependent on a much smaller number of the working age

population. High education expenses may also be due to the stiff competition in the job market. Parents invest much on the schooling of their children by sending them to private schools with relatively high tuition fees. Education was seen as an investment, and a way to improve a household's economic status.

Figure 6-1. Expenses from January to July 2001 in US Dollars



6.2 Saving and Borrowing Practices

Respondents were asked for their reasons for saving and borrowing money; this information was then related to the role of the MSEs in household maintenance.

Reasons for Saving. Almost all of the respondents said that saving money was important and cited that their main reason for saving was to prepare for or cope with any emergency or crisis (Table 66). For these MSE operators, saving money was a relatively effective way of coping with emergencies or crises.

The next reason for saving money was to be able to pay for the education of their children. This is not risk-management mechanism but an investment move. Payment for education is a large "seasonal" investment in their own social security in the hopes that children

will take care of them in their old age.

Table 6-6. Reasons for Saving Money

Reason	%	Rank
Emergency/Crisis	78.6	1
School expenses	35.4	2
Leave for children	25.2	3
Enlarge business	24.8	4
Poor Business	21.4	5
Buy more things (e.g. food)	18.4	6
Retirement	9.9	7
Others	9.2	8
Buy big house	7.5	9
Increase interest of savings	0.1	10

Reasons for Borrowing. The primary reason respondents borrowed money was to support their enterprises, as shown in Table 6-7. Borrowing to pay household expenses was a distant second, followed by education. Borrowing for emergencies was uncommon.

Table 6-7. Reasons for Borrowing Money

Reasons for Loan	First Loan (%)	Second Loan (%)	Third Loan (%)
Business	46.9	16.0	6.1
Household expenses	12.6	5.1	0.3
Education	10.9	3.4	2.0
Others	4.1	2.4	0.3
Emergency	2.7	1.0	0

While respondents cited that they saved money to pay for school expenses, they still had to borrow money to use for the same purpose. This was an indication that the respondents had barely enough income to cover household expenses and business expenses, thus leaving them with little or no money to spend for school expenses.

The other reasons cited for borrowing was to use the money for social events such as wedding, baptism and fiestas (religious festivals). This may mean that available savings facilities are not designed to prepare for such occasions.

6.3 Risks and Risk Perceptions

To assess risks, respondents were asked to identify the income shocks they had experienced in the past eight years. As shown in Table 6-8, illness in the family was the most distressing situation the respondents had to cope with, followed by the occurrence of natural calamities such as typhoons and its natural consequence, flood.

Table 6-8. Income Shocks Experienced by MSEs in the past 8 years

Type of Calamity	%	Rank
Illness in the family	30.6	1
Other Natural calamities	22.5	2
Flood	20.1	3
Loss of Business	10.2	4
Drought	8.5	5
Death	7.1	6
Loss of Property	6.1	7
Others	5.8	8
Death of animals	4.8	9
Accident	4.8	9

To approach this issue from another angle, respondents were asked to identify business-related risks, and to rate these risks according to the effects they may had on their businesses, frequency of occurrence, and the likelihood these events would strike. They were also asked how these risks would affect business operations. The results from this line of questioning are summarised in Table 6-9.

Table 6-9. MSE-specific Risks Identified

Risk	(%)	Effect on Business	Type of Effect	Frequency of Occurrence	Possibility of occurrence
Natural calamity (typhoon, etc)	23.1	2.1 (1.1)*	1.4 (1.1)	2.8 (1.3)	2.5 (1.5)
No profit	23.1	1.7 (0.9)	1.9 (1.4)	3.2 (1.5)	2.9 (1.2)
Unpaid customer credit	20.1	2.2 (1.1)	1.6 (1.1)	3.5 (1.0)	3.0 (1.1)
Others (inflation, no buyer, no supply, etc.)	17.7	1.9 (1.0)	1.6 (0.8)	2.9 (1.5)	2.8 (1.2)
Illness/Accident	15.7	2.1 (1.0)	1.5 (1.0)	3.1 (1.3)	3.5 (1.3)
Competition/Other similar business	9.5	2.1 (1.3)	1.6 (1.0)	2.7 (1.4)	2.3 (1.5)
Fire	8.8	1.7 (1.0)	2.1 (1.8)	3.0 (1.6)	3.4 (1.7)
Theft/ Robbery	6.1	2.5 (0.8)	1.3 (1.0)	3.5 (1.2)	3.7 (1.0)
Debts to be paid	4.4	2.8 (1.2)	1.3 (1.2)	3.2 (1.3)	2.6 (1.5)
Crisis (Economic)	3.1	2.8 (1.2)	1.3 (0.9)	3.3 (1.3)	2.7 (1.0)
No electricity/ Brownout	0.7	2.0 (1.4)	2.0 (1.4)	2.0 (1.4)	2.0 (1.4)
No Response	12.6				

*Figures in parenthesis are standard deviations.

Natural Calamities. With the exemption of the respondents from Davao City, which is located outside of the "typhoon belt" in the Philippines, occurrence of natural calamities was the number one concern. There was a large possibility that calamities would hit the entrepreneurs more than once in a year given the country's geography and location. During the past 3 years 26 typhoons visited the Philippines.

Respondents perceived this risk as severe because it could cause a sharp increase in expenses and temporarily reduce their income. They reported that they worried about this risk only once a month because they lacked effective and appropriate mechanisms to soften the negative impact of this risk. While one can cope with illness or injury by turning to one's social network for help, the effects of natural calamities cannot be easily mitigated because of the high cost of destruction and the covariant nature of the risk—those whom one might turn to for assistance are likely to be affected as well.

Often, the client resorted to loan restructuring and refinancing to manage the impact of calamities. However, restructuring and refinancing will also impact on the MFI as interest income may be delayed and cash flow will be affected.

No Profit. Low demand for their products and services results in reduced earnings for entrepreneurs. There was a high possibility that this would occur during the respondents' entrepreneurial life and would have undesirable effects on their businesses. Although it may only have temporary effects, this perceived risk would reduce significantly the income of the respondents. This finding showed that the respondents were sensitive to fluctuations in the demand for their products and services. Respondents would have to shoulder fixed costs despite reduced demand, thus leaving them with little or no net income.

Unpaid Customer Credit. This was the third business-related risk identified by the respondents. They considered this a somewhat severe risk, but something they rarely worried about. Most respondents said that unpaid customer credit had a 50:50 chance of occurring in their business and would reduce their income significantly for a while.

Illness and Accident. Respondents mostly conducted their businesses in public markets or on the streets where they were exposed to many occupational and health hazards. Illnesses and accidents to the entrepreneurs themselves was an identified risk. Although the respondents worried rarely about this risk, they identified it as severe.

The respondents, especially by women, also perceived illness of a family member as a

risk. Even if the sick person is not an income-earner, illness can reduce income because the mother usually has to leave her business to take care of a sick family member.

Illness or injury of MSE operators, either short or long term, not only decreased productivity; it also decreased income and in worse cases, depleted savings. This risk had severe effect on MSEs and their households due to the direct costs (hospitalisation expenses and medicine costs) and opportunity costs. During the past 12 months, the maximum number of household illness days experienced by respondents was more than two years and the mean was almost a month (see Table 6-10). The mean expense of P10,476 (USD 210) was nearly twice the monthly minimum wage in the country.

Table 6-10. Illness in the Family in the Past 12 Months

Item	Min	Max	Mean	Standard deviation
No. of Persons	1	9	1.5	1.3
No. of days sick	1	730	25.5	91.0
No. of occurrence	1	12	1.5	1.6
Expense (in US Dollars)	1	6,000	209.5	

In addition, respondents worried about illness in the family due to their lack of access to health care. The respondents spent an average of 6.2 days per week and 9.4 hours per day working in their businesses. If ever they needed to access health care, they would incur high opportunity costs.

Competition. Respondents perceived competition from other enterprises as a risk. This concern was understandable because many respondents operated in a highly competitive market where there were little or no entry barriers. The respondents seldom worried about this risk, but it could have an income-reduction effect on their businesses.

Fire. According to the respondents, fire could have a severe effect on their enterprise, wiping out their income and assets. Yet respondents rarely worry about this risk for they felt that fire was unlikely to happen.

Theft. For respondents who conducted their business on the streets and other unsafe areas, loss of business assets due to theft and robbery was not uncommon. It would have a moderately severe effect on the business, but respondents believed it was unlikely to happen to them. Loss of any of their assets could reduce earnings for a while or, in worst cases, leave the entrepreneur unemployed.

Debts. Absence of savings pushed the MSEs to borrow money from different sources during crisis. Respondents who had limited access to formal lending institutions turned to informal sources when hit by a sudden crisis.

6.4 Risk Management Practices Employed by MSEs

To better understand the risks faced by the MSE operators and the risk management practices they employed, the identified business-related risks were categorised into idiosyncratic and covariant risks at the micro, meso and macro levels (Table 6-11). The difference between these levels depends on who are hit and the underlying causes. Micro risks hit an individual or a household. Unpaid customer credit, for example, is a micro idiosyncratic risk when caused by either the MSEs' poor collection system or the clients' unwillingness to pay. It can be a meso covariant risk if it strikes a group of MSEs in a community and was caused by clients' inability to pay due to the poor economy. Macro risks, on the other hand, strike a large number of individuals because they occur at a national or international level.

Table 6-11. Typology of MSE-related Risks

Idiosyncratic Risks	**Covariant Risks**	
Micro risks	Meso risks	Macro risks
Unpaid customer credit	Unpaid customer credit	Natural calamities
Illness/accident	Competition	
Theft	Fire	
Debts to be paid	No electricity	
No profit		

Source: World Bank. Quality of Growth 2000

Covariant and idiosyncratic shocks can put MSEs in difficult financial situations. Occurrence of these shocks may wipe out the entrepreneurs' savings and assets, and decrease their income. MSEs have developed various mechanisms to cope with these different risks, as summarised in Table 6-12.

Table 6-12. Risk-management Mechanisms Practiced by MSEs

Type of risk	**Risk**	**Risk management practices**	
		Monetary	Non-monetary
Micro	Unpaid customer credit		Improve collection system
	Illness/injury	Savings, join health insurance	Ask children to help in business
	Theft		
	Debts to be paid	Enrol in co-operatives and NGO-MFIs	
	No profit	Savings formation or membership in ROSCAs	Decrease production
Meso	Unpaid customer credit		
	Illness/injury	Savings, join health insurance	
	Competition	Loan for more capital to improve business competitiveness	Be more competitive by improving business management
	Fire No/decrease in profit	Savings	Fire prevention measures
Macro	Electricity failure Natural calamities	Enrol in government and formal insurance to avail of calamity loans	

6.5 Savings to Cope with Risks

MSEs employed both monetary and non-monetary instruments to mitigate or cope with risks. Savings, however, was the most commonly used coping strategy, and therefore it merits particular attention.

For savings to be an effective risk-coping mechanism, MSEs must accumulate wealth during good times so they can withdraw when calamities or other shocks arise. MSEs may have been relatively successful in coping with shocks through savings because the survey has shown that MSEs seldom borrow money to pay for emergencies.

The capacity to save was contingent on the amount of income a household earns: the greater the income, the greater the capacity to save and invest. Therefore, savings was effective only when the MSEs had a regular and smooth inflow of income and if they have not faced any previous cash shortfall. MSEs enumerated a number of factors that hindered them from saving money, as shown in Table 6-13.

Table 6-13. Reasons for Difficulty in Saving Money

	% Respondents
Illness in family	28.2
Put money in my business	25.8
Too many dependents	25.5
Payment of debts	23.5
Poor business	22.8
No safe place for saving	1.7
Spouse getting my money	1.0

Respondents identified illness as a main reason for savings difficulties, which reinforces

the finding that this is the primary vulnerability of low-income households. A key reason it received such a prominent response is because illness comes on unexpectedly and disrupts the normal spending/saving pattern of a household. Illness was not only an additional expense, but also it tended to reduce income-earning potential. Depending on the degree and nature of the illness, it could deplete whatever savings the household had accumulated.

Another reason MSEs have difficulty saving is because they prefer to reinvest additional cash in their businesses. Roughly a quarter of the respondents felt that they could get a better return on their investment by increasing their stocks or purchasing business assets than saving in a bank or a ROSCA.

The most common reason why MSEs had difficulty saving, however, is because they did not have sufficient funds, either because they had too many debts to repay, or they had too many dependents thereby increasing household expenses, or the business was not generating sufficient cash—perhaps due to low demand, unpaid credit, competition, or increasing costs of production. These business problems are perhaps best addressed through training and other business support services rather than through financial services.

6.6 Microinsurance

Because of the apparent difficulties in saving, and because saving can be an insufficient risk coping strategy for large losses, this study also considered the MSE's attitudes toward, and potential demand for, insurance. All respondents were asked about their definition of and attitudes towards insurance. Then they were asked if they had insurance policies or planned to enrol in an insurance scheme. Those who did not have insurance, and were not interested in getting a policy, were asked to cite their reasons. The potential demand for insurance was identified by looking at the respondents' profile, shocks they faced, and the risks they identified.

6.6.1 Attitude Towards Microinsurance

There was a general openness towards insurance. Respondents said that insurance could help them achieve stability and business growth. Many respondents identified insurance schemes run by their MFIs and the traditional *damayan* schemes operating in the community as beneficial. The practice of *damayan,* though positioned more as social solidarity than as insurance, was widespread.

Some reasons for the respondents' high acceptance of microinsurance was the small cost of premium and the frequency of payment which were more suitable to their paying capacity, as demonstrated in Tables 6-14 and 6-15.

Table 6-14. Premium Cost Of Microinsurance

Item	Min	Max	Mean
Premium (in P)	10.00	100,000	1,820
Membership (in years)	0.25	37.00	7.2

Table 6-15. Frequency Of Payment

Category	%
Weekly	33.0
Annually	13.9
Monthly	10.2
Semi-annually	9.9
Daily	2.4
Quarterly	2.4

6.6.2 Potential Demand for Insurance

Despite the diverse coping strategies employed by MSE operators, there were still unmanaged risks and vulnerabilities. Of the major risks that the respondents identified, only some can be managed through informal coping mechanisms, suggesting a potential to expand the

provision of microinsurance products, especially related to illness and natural disasters.

Respondents perceived illness and accident as a major risk. Illness was the number one income shock they experienced and a major reason for savings difficulties. The respondents' expenses for health were relatively small, frequent, but highly unpredictable. This unpredictability makes it difficult to manage this risk through savings. Since the government and private HMOs have not effectively reached the informal sector, it opens up a huge potential market for MFIs to service.

Respondents were mostly middle-aged women with several dependents. They were exposed to gender-specific risks and expenses. The nature of the respondents' enterprise made them vulnerable to diseases and prevented them from accessing primary health care services. Women entrepreneurs would greatly benefit from insurance that will consider their profile and the nature of their businesses in the product design. Health service delivery, marketing and collection systems should be tailored to the needs and paying capacity of women entrepreneurs. Maternity benefits and access to affordable primary health care will greatly help them.

In addition, illness in the family resulted in missed days at work and income reduction. Illness and accident do not only have direct hospitalisation costs but also posed large opportunity costs. Creation of income insurance should limit the MSE operators' earning losses due to illness or from having to take care sick family member/s. Such a feature would have to be carefully designed to prevent over-usage and fraud.

Lastly, the number one risk the MSE operators were worried about was the occurrence of natural calamities, especially because this risk was not effectively managed by any existing coping practices. The MFIs and the MFI-owned corporations did not have any mechanisms to mitigate this risk for the MSE operators. If such insurance could be provided, and if it could be reinsured, it would also benefit the MFIs since their business loan portfolio would not suffer as significantly.

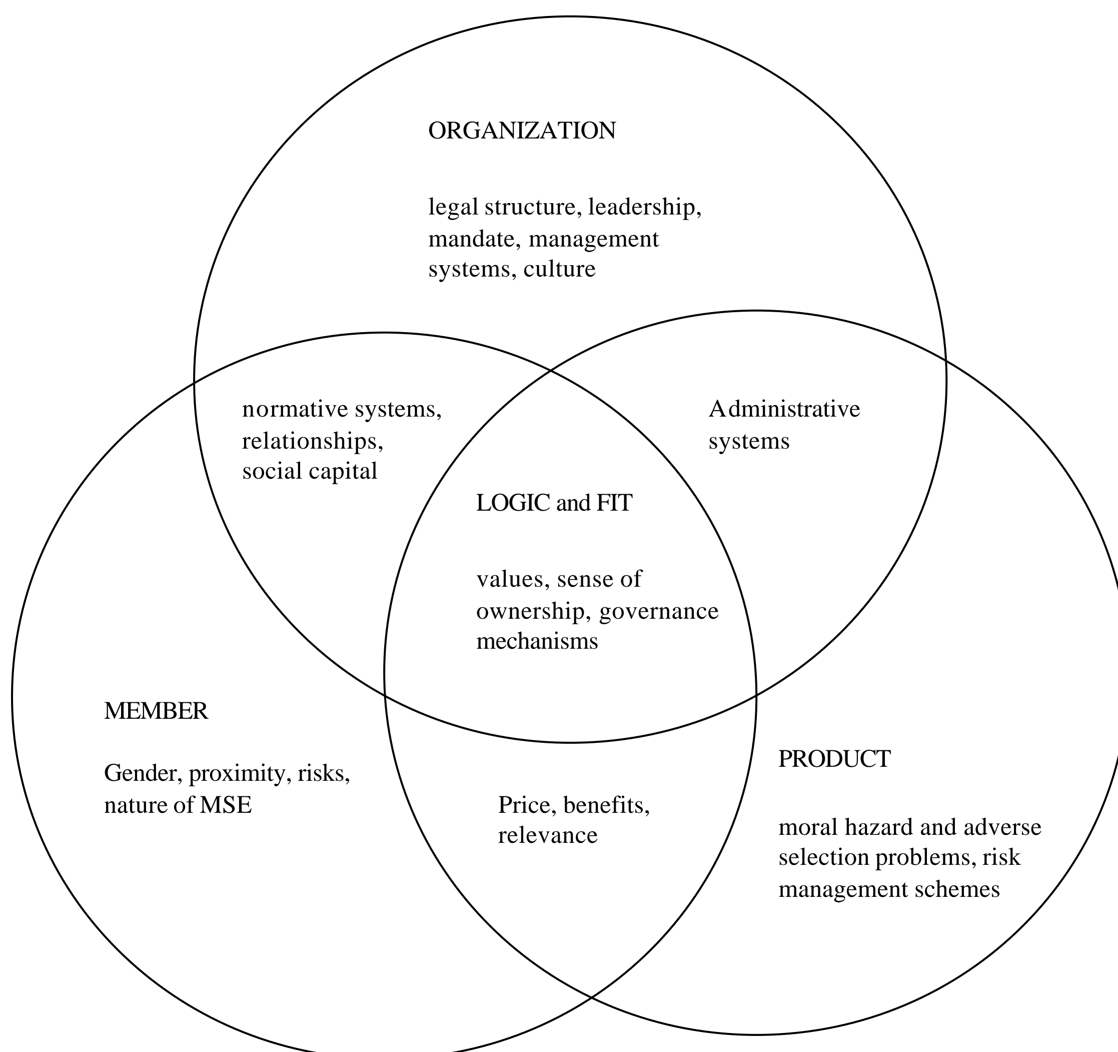
7.0 Framework for MFIs and Microinsurance

Two frameworks can be drawn from the information gathered in the study: 1) at the level of insurance product design and delivery; and 2) at the level of the markets that these insurance products are sold.

7.1 Operations Framework of Microinsurance

Three major elements influence the way microinsurance is delivered—the MFI structure, insurance product qualities and client profile—as represented by the three overlapping circles in Figure 7-1.

Figure 7-1. Key Elements of Microinsurance Operations by MFIs



Institutional Factors. As discussed in section 5.3, the type of institution has a significant influence on microinsurance. The legal structure, ownership and governance, leadership, mandate, management systems, and culture influence the organisational context of the microinsurance program.

In the overlap between organisation and product are the administrative systems that allow it to manage the transactions needed to deliver the microinsurance product, from claims

processing to collections to fraud control. Efficiency, convenience, and complexity of these administrative transactions are factors in the MFI's preference to manage the insurance scheme itself or to partner with a formal insurer.

The organisation influences member behaviour through its normative systems, relationships, and social capital. Norms within the organisation are shaped through formal policies and procedures, as well as unwritten rules. Social pressures to conform to the norms are particularly strong in Grameen-type MFIs. Social capital allows the organisation to absorb social tensions that go with experimentation in microinsurance. These social dynamics reduce information asymmetries, moral hazard problems, and transaction costs in ways that are not possible with formal insurance contracts.

Member Factors. Member variables include gender, proximity to MFI facilities, risks, business type, and length of membership in the MFI. Members are sensitive to the price, the benefits, and the relevance of the insurance product as far as their perceived risks are concerned.

Product Factors. Technical aspects of insurance—such as the possibilities of moral hazard, adverse selection problems, as well as the risk management schemes used—are variables that influence the design of the product.

The insurance mechanism is a relationship between the member and an insurer or peers in a risk-pool. This relationship is guided by values of solidarity, social responsibility or utility, or a combination of these values. Ownership over the risks and the benefits from participating in an insurance scheme make risk sharing possible. The governance mechanisms provide a vehicle for negotiating the terms of the relationships in the microinsurance project, and create the political legitimacy for new policies.

All of these contribute to the logic of the insurance relationship as understood by the MFI and the members. It is important that a *fit* is achieved in this convergence point. Otherwise, dissonance will result and destabilize the social, actuarial, and financial equilibrium in

the microinsurance project.

7.2 The Technologies and Markets of Microinsurance

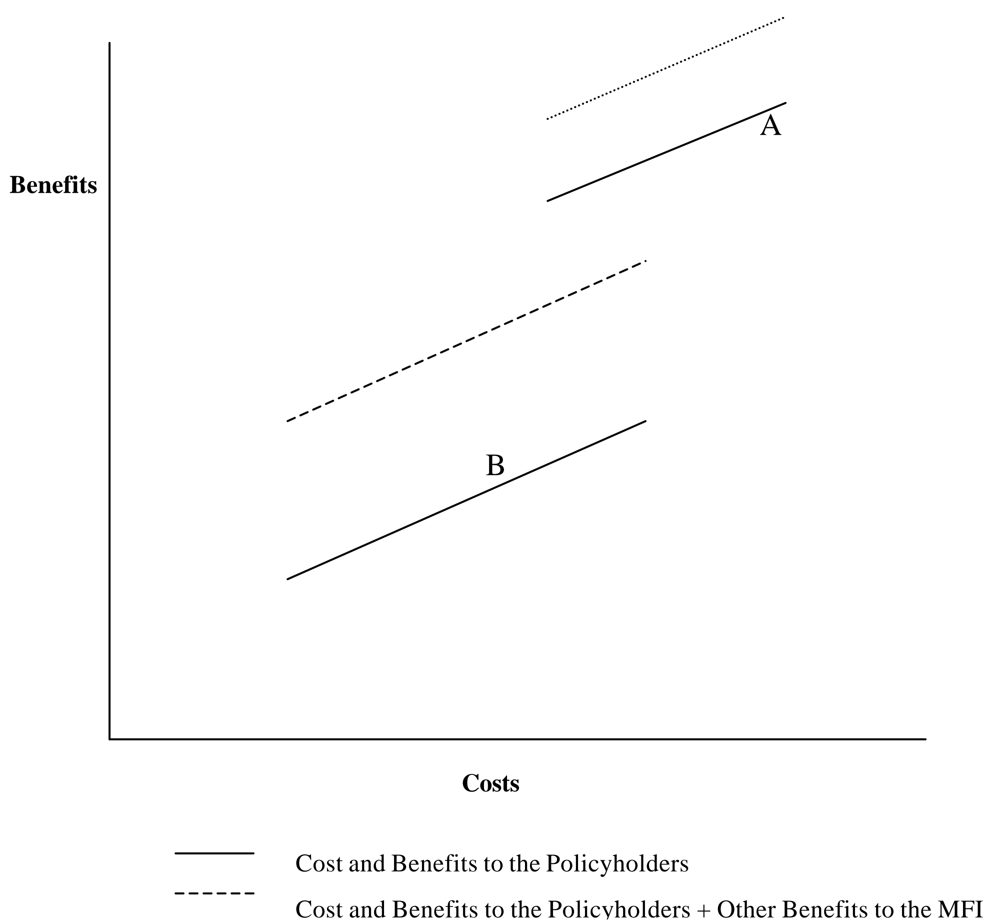
On another level of representation, the suppliers of microinsurance can be located in a graphical representation of their markets and technologies. The costs and benefits of the products are located on two curves of a graph seen in Figure 7-2. The X-axis represents the costs of insurance to the member and the Y-axis represents the benefits of insurance to the member and the MFI. Different microinsurance products can be located in the graph based on their costs and benefits.

Curve A is higher and to the right of the graph indicating higher costs and higher coverage per peso due to larger risk pools and optimisation of the actuarially feasible benefits. Formal insurance firms that use rigorous actuarial studies to optimise the benefits achieve this level. Curve B is lower and to the left of the graph indicating lower scale operations, lower costs and lower benefits per peso. The products of indigenous insurance, done through group self-insurance or risk pooling, can be found on this curve. There are lower costs and benefits per peso.

The MFI-owned insurance schemes, like CLIMBS and CISP, operate in the lower levels of Curve A, but use the same actuarial technology as other formal insurers. They reach the informal sector with low transaction and marketing costs by working closely with co-operatives. They also pay dividends to their co-op members that reduce the net cost experienced by clients.

Microinsurance from NGOs and co-operatives is typically found on Curve B. It is possible that the insurance provided by MFIs is not always actuarially feasible. This situation might occur when they adopt the products of formal insurance firms, using the same premium and benefits. These products may not be viable because the MFIs have a smaller and possibly

Figure 7-2. Cost and Benefits of Insurance



Cost and Benefits to the Policyholders

Cost and Benefits to the Policyholders + Other Benefits to the MFI

more homogenous risk pool, and they lack reserves and reinsurance. Although the lack of actuarial basis for computing the premiums and contributions is risky, the MFIs seem to prefer this approach to not providing insurance or to paying high consultancy fees of actuaries.

Factors that shift Curve B to the left or to the right are transaction costs. With the integration of insurance into other operating systems of an NGO or co-op, the transaction costs are lower, shifting the curve to the left. For members, this integration represents a better value for the money. Opportunity costs are also lower compared to formal insurance, especially when there is a very efficient collection system wherein members do not have to go out of their way to pay premiums. Marketing costs are lower because the market is easily accessible and captive.

Of the three types of MFIs studied, risk sharing is employed only by the co-operatives. Risk pooling, where the burden of risk is on the MFI, was seen in all three types of institutions. In the agency system, the burden of risk is shifted to the insurer. Technically, only the MFI-owned insurers can operate on Curve A. The small risk pool and the lack of actuarial analysis prevent the co-ops and NGOs from achieving that level without an agency agreement with a formal insurer. Otherwise, NGOs and co-operatives operate on Curve B—lower costs, but lower benefits, and less value for money.

The three types of MFIs reach the informal sector in different ways. MFI-owned insurance companies make products that are found in Curve A but in the lower levels; the marketing costs are lower because they work closely with the co-operatives who are also their stockholders. The NGOs are able to produce insurance products on Curve B that are more affordable to the informal sector, through risk pooling, lower information asymmetries, lower transaction costs, and possibly some gross subsidies. The same goes for co-operatives, except that their social capital allows management to innovate. The co-op members' ownership of the risks substitutes for the high reserves needed to buffer against design flaws during the experimental stage of product development. This social capital, in the form of participatory product development, also reduces the R&D costs.

Table 7-1. Risk Management Profiles of the Three Types of Institutions

	Co-op MFI	NGO MFI	MFI-owned Insurer
Risk sharing (burden of risk on members)	Yes	No	No
Risk pooling at institutional level (burden of risk on MFI)	Yes	Yes	Yes
Agency (burden of risk on insurer)	Yes	Yes	No
Curve	B	B	A
How the informal sector is reached	Lower information asymmetries Lower transaction costs Cross-subsidies Social capital	Lower information asymmetries Lower transaction costs Cross-subsidies	Make products at the bottom end of Curve A Lower marketing costs Dividends

8.0 Lessons for Microinsurance Development

The microfinance sector in the Philippines has just begun to play an active role in the insurance market. To date, they have been able to provide insurance products in life, credit-life and health. This section presents insights drawn from the study, including the scope for new products and lessons in product design. It also raises issues regarding regulation and state intervention.

8.1 Scope for New Products

Section 6 discussed the MSE operators' demand and need for insurance and showed that low-income households were vulnerable to a number of risks. Section 5 described various microinsurance products offered by MFIs. Between the supply and demand emerge a number of gaps, especially regarding illness and natural disasters.

The number one risk worrying MSE operators was the occurrence of natural calamities.

This risk causes a spike in expenses while temporarily reducing their income. More importantly, entrepreneurs could not manage this risk through their existing coping practices. MFIs need to develop mechanisms to mitigate disaster risk for their clients—and for themselves since their loan portfolios are also affected. Disaster insurance provided by MFIs as an agent for a formal insurer that has reinsurance could be an enormous service to the informal sector.

Another major risk for the MSE operators was illness and accident, to the entrepreneurs themselves and to their family members. Health expenditures of low-income households were unpredictable. When coupled with the opportunity costs of being away from one's business, due to ill health or to care for a family member, MSE operators were exposed to acute income and expense shocks. Currently, only 3 out of 6 MFIs in this study were addressing the huge demand for health and accident insurance.

Women entrepreneurs have the greatest need for health insurance improvements. Current insurance products and health care services, even those being offered by the MFIs, do not consider the special situation of the women entrepreneurs in the insurance design. For example, income-loss insurance, to compensate women entrepreneurs who leave their businesses to serve as caregivers, was not available.

The three types of microinsurance products provided by MFIs were inadequate to cover the various risks of the informal sector. Ideally, there should be more microinsurance products in the market, as well as loan and savings products that serve a risk management purpose. For example, loans for education financing or home improvement could help reduce risks and may have synergies with microinsurance. For these products to emerge, more research and development is required.

8.2 Lessons in Product Design and Delivery

There were a number of serious flaws in the products currently available, some of which

the MFIs have already identified and addressed. This section summarises some of the main lessons in product design and delivery.

Bundling of Microinsurance Products. It was common for co-ops to offer a product that combined health and life insurance. This insurance package likely lowers the marginal costs for the provision of each type of insurance, which should benefit the members. However, if MFIs are unable to manage the risks per product, it is possible that they are unnecessarily vulnerable. The bundling of voluntary insurance products increases the problem of adverse selection. In addition, management problems may occur because different sets of skills are needed to provide different microinsurance products.

While the packaging of life and health products together may make sense from a marketing perspective (although that is certainly debatable), it is critical that the income and expenses be disaggregated so that the insurer can offer appropriate benefits and calculate a viable premium. Furthermore, microinsurers have a moral obligation to provide consumers with information about the costs directly associated with each product.

Minimising Transaction Costs. Transaction costs primarily occur at five different stages: marketing and sales, screening and enrolment, premium payments, claims verification, and claims payments. In general, the microinsurers in this study did an exceptional job of keeping their transaction costs to a minimum, especially costs associated with marketing and premium payments. The NGO-MFIs integrated the premium payment with a loan or savings transaction, so there is not any additional transaction. The co-ops deducted premiums from dividends or special accounts that members needed to replenish. A move toward eliminating all over-the-counter premium payments would further enhance efficiency.

Mandatory Policies. A number of the microinsurance policies available from MFIs are mandatory for members or borrowers. On the one hand, this makes social protection for their members more efficient and effective, as marketing costs and transaction costs are substantially reduced. In addition, mandatory insurance minimises adverse selection problems since high-risk persons cannot opt in while low-risk persons opt out. On the other hand, mandatory insurance

could be abused by the MFIs, especially if products are more expensive than market prices (although this is particularly hard to gauge given the lack of transparency in pricing). The benefits that microinsurance brings to MFIs, such as extra liquidity and profits, might tempt MFI managers to abuse the situation.

Risk Management. Several Philippine microinsurers have learned about managing risks the hard way. Since they approached insurance largely from a benevolent perspective, some MFIs only started building in risk management policies once they found members taking advantage of the system. Risk prevention techniques that should be considered upfront—and which are pervasive in the insurance industry—include:

- Waiting Periods: Several MFIs now have policies whereby members are not eligible for insurance cover until after an initial period of time. These policies are intended to reduce the chances that someone with a terminal illness will purchase a life insurance policy, for example, knowing that they are likely to die in a couple of months.
- Exclusions: Policies that exclude coverage for high-risk members, such as persons over 65 or those with pre-existing conditions, are necessary to contain claims costs and make the product affordable to the broader low-income market.
- Screening Techniques: Requirements to furnish health certificates to be eligible for insurance significantly increases the transaction costs to the clients and the insurer, but they are probably necessary for larger policies (e.g., credit-life cover for large loans).
- Graduated Benefits: Because of information asymmetries, some MFIs have lower benefit ceilings for new members. Once they get to know the member better, then the maximum benefit increases. These graduated benefits also serve as an incentive for customer loyalty.

Microinsurers that approach the provision of insurance as a social service are unlikely to

provide that service over time. If they overlook or loosely implement important risk management policies, and if they price their products based on affordability rather than viability, they are likely to exhaust their financial resources in due course. When the inevitable occurs, no one will benefit.

8.3 Improving the Production Chain of Microinsurance

Improvements to microinsurance can follow along the production chain, starting with the organisational development of MFIs as microinsurance suppliers, to the acquisition and development of microinsurance technologies, and then finally to marketing these products. This discussion will project a possible future scenario for microinsurance, and then identify the gaps and constraints that need to be overcome. State interventions that might be needed to achieve this outcome are also discussed.

8.3.1 Organisational Factors

A possible scenario is that MFIs effectively address the demand-supply gap for microinsurance products. This scenario is logical because MFIs are already engaged in financial transactions with a large percentage of the low-income market, which enables them to be a cost-effective delivery vehicle.

In this situation, there should be adequate, effective, and stable MFIs providing relevant microinsurance products. To achieve this outcome, MFIs need a significant injection of skills and knowledge on microinsurance management, as well as technical support to implement technically sound microinsurance operations.

The development of MFIs as microinsurers may be accelerated by the creation of a training program that will transfer microinsurance expertise to MFI managers. The NGO-MFI

networks, coalitions and co-operative confederations would be appropriate bodies to provide these trainings. For example, the National Confederation of Co-operatives (NATCCO), one of the biggest and most extensive networks of co-operatives in the country, can be tapped to deliver microinsurance training.

The MFI-owned corporations like CLIMBS and CISP can also facilitate the transfer of microinsurance know-how to MFIs. In addition, to expand the availability of insurance through MFIs, it would be advantageous to identify and overcome the obstacles that prevent co-ops from acting as agents to sell the insurers' Curve A products.

MFIs may also benefit at this point from some self-regulation so that initial standards can be set and then evolve over time. This will protect members as well as MFIs from unnecessary design flaws as the microinsurance technology develops.

8.3.2 Technology Development and Dissemination

Microinsurance technologies are still in their infancy. At this stage, the regulatory environment should foster experimentation and innovation so that technologies will mature. State subsidies for R&D and lesson sharing can be justified during these early days since it is unlikely that the private sector would be willing to make such investments.

The second stage of technology evolution would be testing in a competitive market to see which approaches will become dominant. When microinsurance technologies become more widespread such that they effectively cover the market, then regulators may opt to increase the standards so that MFIs become more cost effective and stable. At this subsequent stage, the objective of regulation will be to encourage increased accountability, efficiency, effectiveness and stability, and to weed out the inefficient and the ineffective schemes.

Ratemaking and reinsurance may be possible at this point when the technologies of microinsurance have matured. Ratemaking and reinsurance will provide an extra measure of risk

reduction to the microinsurers as well as the policyholders. There is a pressing need, however, to identify cost-effective arrangements for accessing actuarial services.

8.3.3 Marketing

Currently, marketing of microinsurance has been done through mandatory add-ons to membership or loans, or as optional services that members could avail of. A second marketing strategy has been to institutionalise indigenous *damayan*-based schemes, highlighting the compatibility of insurance with local customs. These two marketing approaches may be the key strategies for making microinsurance coverage widespread, drastically cutting down marketing costs compared to formal insurance marketing strategies.

While state-run social security is still unable to reach the informal sector, the government may help promote MFI-based microinsurance schemes by subsidising marketing campaigns to bring more individuals from the informal sector under microinsurance coverage.

Another important role either for the government or a self-regulatory body would be to enhance transparency in pricing and ensure consumer protection in marketing. MSE operators are often passive consumers of microinsurance, sometimes unknowingly paying premiums and unaware of the benefits. Consumer competence may be improved by making price information more widely available, and compelling MFIs declare the various processing fees and other costs bundled into the loans. When consumers are well informed about their options on microinsurance, then the market will work better and superior microinsurance products will emerge.

8.4 Conclusion

MFIs have unique capabilities to cost-effectively delivery microinsurance to the informal

sector. Microinsurance complements the MFIs' other interventions with MSEs because it reduces their vulnerability to business and personal risks.

Microinsurance is a new technology, and innovations are emerging rapidly. Such lessons need to be documented and disseminated to help the microfinance sector effectively address the need of the informal sector for microinsurance.

Just as microfinance has gained widespread acceptance as an effective development strategy; microinsurance, too, promises to be a sustainable approach to risk management for the informal sector. MFIs are currently in the best position to provide microinsurance to the informal sector and should actively experiment and innovate to make the mainstreaming of microinsurance a reality.

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